

QUEEN MARY, UNIVERSITY OF LONDON
FACULTY OF HUMANITIES AND SOCIAL SCIENCES

School of Law

**The Application of Article 101 of the Treaty of Lisbon to forms of
horizontal collaboration in the Financial Services Sector**

by

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ABSTRACT

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**THE APPLICATION OF ARTICLE 101 OF THE TREATY OF LISBON TO
FORMS OF HORIZONTAL COLLABORATION IN THE FINANCIAL
SERVICES SECTOR**

By Andrea Lista

Since the dawn of the European Union, insurance and banking undertakings claimed to be subject to a special status vis-à-vis the application of EU competition law, due to the quasi social nature of the services they provide.

Within the financial services industry, anti-trust concerns do arise in relation to mergers and acquisitions, possible abuses of dominant position and state aid; however Art. 101 TFEU and the regulation of forms of co-operation arguably represent the paramount and most intricate aspects of the application of the EU competition rules to the financial services sector. This is due to the fact that the insurance and banking industries historically have been characterised by intense forms of horizontal co-operation between undertakings deemed necessary for the correct functioning of the financial services industry.

On a general level, any agreement establishing a homogeneous pricing structure vis-à-vis consumers represents a blatant violation of Art. 101 TFEU giving rise to serious anti-trust concerns. Nevertheless, as will be explored in this thesis, in the financial services sector the Commission has often allowed what the doctrine has correctly defined as “forms of horizontal agreements concerning a relevant cost element making up the final price vis-à-vis customers”¹ through its decisions relating

¹ See Faull & Nikpay, “The EC Law of Competition” OUP 2007, p. 636.

to interbank fees in payment systems and through the enactment of a block exemption for the insurance industry. Art. 101 thus seems to manifest a common element for these two industries, presenting interesting and intricate teleological quandaries. This thesis endeavours to break the impasse down into questions to which an answer may be provided: Ought Art. 101 to apply to the financial services sector at all? If so, to what extent? Is there any justification for a block exemption in the insurance sector? Indeed, should the banking sector too benefit from a block exemption?

This thesis endeavours to answer the above questions and thereby to contribute to the identification of an ideal regulatory framework for forms of horizontal co-operation in the financial services sector.

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The usual disclaimer applies.

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To the memory of Professor Gerrit Betlem

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INTRODUCTION

Aims and Objectives

Competition law is a constantly evolving legal field; although characterised by an idiosyncratic and technical nature, competition law has an inestimable influence on numerous areas of law and on rules of politics and economic policy. Its principal function is to safeguard and preserve a free market system, promote and facilitate the competitive process within the economic market, endeavouring to achieve an optimum allocation of resources and the maximisation of consumer welfare.

In a market without any form of control, undertakings would be prone to adhere to collusive forms of behaviours with the aim of fixing prices, those in a dominant position would misuse their market strength, and an excessive number of mergers would lead to high concentrations of economic power. Such practices would invariably obstruct or inhibit the competitive process within a specific market.

The primary purpose of this thesis is to evaluate the scope of application of Art. 101 of the Treaty of Lisbon² within the sphere of the financial services sector (banking and insurance). During the last few years, the financial services sector has witnessed events and legal developments of the utmost importance, the first of which took place five years ago, when the Commission launched a sector enquiry into the financial sector³. The attention of the Commission focused on the financial services

² Art. 101 of the Treaty of Lisbon (hereafter “the Treaty”), former Art. 81 EC.

³ The European Commission launched inquiries into competition in financial services in June 2005, pursuant to Article 17 of Regulation (EC) No 1/2003. The financial services sector enquiry focused on payments cards and business insurance. See the Commission “*Inquiry into the European business insurance sector pursuant to Article 17 of Regulation 1/2003*”, January 2007, available at:

as a sector providing key inputs into a range of other commercial activities, the aim of the enquiry being the identification of possible idiosyncrasies in the insurance and banking sectors giving rise to possible competition concerns.

The years 2006 and 2007 were years of the utmost importance for the financial services sector, with the publication of the Reports on business insurance in 2006 and the Reports on the banking sector and card payment systems in 2007. More recently, a deep financial crisis reverberated through the global economy, and a new insurance block exemption regulatory framework was enacted in March 2010.

In light of these recent developments, the aim of this thesis is to critically consider the controversial issues surrounding the application of Art.101 of the Treaty to the financial sector, in order to assess its effectiveness and to ultimately propose possible alternatives at a time when the situation characterising the internal market appears mature for the introduction of important reforms.

- The thesis will take into account in the first place the development of the EU competition policy from the outset of the Community in order to introduce a general overview of the complex issues characterising this area of law, and will prove the existence of a common thread linking the insurance and banking sectors.
- The thesis will focus on the current block exemption regulatory framework of the insurance industry in order to identify its scope of application in light of previous Commission decisions, and to critically evaluate the main controversial issues and the concrete impact of the block exemption on the insurance sector.

http://ec.europa.eu/competition/sectors/financial_services/inquiries/interim_report_24012007.pdf. See also the Commission "*Inquiry into the European Retail banking sector*", April 2006, available at: http://ec.europa.eu/competition/sectors/financial_services/inquiries/interim_report_1.pdf. Accessed on 3 July 2011.

- The thesis will reflect on the US insurance antitrust approach in order to introduce a comparative evaluation of the European regulatory framework. Together with a detailed analysis of the reasons *pro et contra* a block exemption in the insurance industry, this comparative evaluation is intended as a basis for the elaboration of possible regulatory alternatives.

- The thesis will consider the current EU regulatory approach of the banking sector. Emphasis will be devoted to competition concerns arising in relation to card payment systems. Both price and non-price competition issues will be taken into account with a specific reference to Multilateral Interchange Fees, No Discrimination Rules, Exclusion Rules and Exclusivity Rules. Yet again, a comparative element (the US approach) will be taken into account with the intention of exploring possible alternative regulatory scenarios.

- The thesis shall draw parallels with the Application of Art. 101 to other sectors of the economy. Due to structural similarities, the attention will focus on the telecommunications and energy sectors. As it will be readily appreciated, this comparative analysis will provide some interesting ‘outward looking’ elements of considerations on the basis of which the conclusions reached on the application of Art. 101 to the financial services sector will be counter balanced.

- Finally, the thesis shall endeavour to consider whether the regulatory approach related to the application of Art.101 TFEU to the financial services sector should be

consistent for both insurance and banking industries, or whether a divergent regulatory frameworks would be justified.

Structure and Methodology

The thesis is divided in five parts preceded by a chapter outlining the common features of insurance and banking industries. Part I will set the scene considering the common features of the insurance and banking sectors, and the importance of the application of Art. 101 to this area of law. Part II will deal with the application of Art. 101 to the insurance sector. Part III will reflect on the evaluation of the application of the EU antitrust regulatory framework stemming out of Art. 101 to the banking industry. Part IV will consider comparative elements arising from the application of Art. 101 to the energy and telecommunication sectors. Part V will illustrate the possible way forward. Part VI will provide some concluding remarks.

More specifically, Part I shall identify the questions to be addressed by this thesis, drawing a parallel on the similarities between the banking and insurance industries, and emphasising the *raison d'être* for the choice to focus the analysis solely on the application of Art. 101.

In Part II, the theme of research is to investigate the essence of the current regulatory framework of the insurance industry stemming out the application of Art. 101 and its concrete impact on the internal market.

The chapters relating to this part will comprise an introduction of the main issues relating to the application of EU competition law to the insurance industry in conjunction to the evolution of the impact of Art. 101 TFEU. The evaluation of the EU and US antitrust regulatory approaches in relation to the insurance industry will then be considered, together with the critical assessment of the concrete impact of

the current EU insurance block exemption on the internal market, and the suggestion of possible avenues to its reform.

The underlying thread connecting the chapters of the first part is the quest for possible regulatory alternatives and reforms of the EU antitrust regulatory regime of the insurance industry. In doing so, the evaluation of the concrete impact of the insurance block exemption regulation on the internal market will play a crucial role; alternatives and possible reforms will be in fact carefully assessed not only against theoretical arguments, but also in light of their possible impact on the internal market, with a specific reference to consumer welfare.

In Part III, the theme of the aim is to investigate the current EU antitrust regulatory framework relating to the banking industry. Emphasis will be on the controversial competition issues arising from the retail banking systems. Both price competition and non-price competition issues will be object of analysis.

The attention will be devoted first to price competition issues arising from the use of Multilateral Interchange Fees and Discriminatory Rules by card payment networks. The main Commission decisions and ECJ⁴ judgments will be taken into consideration, together with the analysis of the US approach. Similarly, a critical analysis of the non-price competition issues arising from the controversial exclusion and exclusivity rules adopted by card payment systems will then be carried out taking into account the US perspective.

Yet again, the underlying link of the second part will be the attempt to identify and explore possible avenues to reform the current EU antitrust regulatory

⁴ With the entry into force of the Treaty of Lisbon, a new nomenclature has been introduced in relation to the European Courts. The European Court of Justice (ECJ) is now formally the Court of Justice, and the formerly Court of First Instance is now the General Court. Notwithstanding the new nomenclature, in this thesis reference is still made to the ECJ and the Court of First Instance.

framework of the banking sector. Similarly to Part I, the analysis of the US approach will reveal itself as an invaluable instrument of debate.

In Part IV, the attention will be turned to the application of Art. 101 to the energy and telecommunication sectors in the quest for the identification of possible rebuttals or confirmations of the modifications of the legal framework revolving around Art. 101 suggested in the previous parts of the thesis for the insurance and banking sectors.

This thesis will identify the most complex issues arising from the application of Art. 101 TFEU to the financial services sector. It will be established that forms of co-operation capable of being caught by Art. 101 are extensively present both in the insurance industry and in the banking sector.

It will be emphasised how these forms of co-operation have traditionally been justified by a *sui generis* nature of the banking and insurance services, underpinning tolerance of a block exemption in the insurance industry, and a relaxed application of Art. 101 to the banking sector. We shall critically consider the rationale and real impact of these forms of co-operation on the market, suggesting in each case a different regulatory regime.

In Part IV, we shall proceed above and beyond the ‘internal’ line of reasoning pertaining to the financial services industry and draw a comparison between the application of Art. 101 in this area and different segments of the market. All this in the quest for the identification of possible rebuttals or confirmations of the findings of previous parts of the thesis, with a view to setting the scene for the last part of the conceptual journey of this “literary vessel”.

It is opinion of the author that for the purpose of this thesis it is worthwhile to channel the attention to the telecommunications and energy sectors. The rationale for

this choice lies with the similarities which characterise these two sectors if compared to the financial services industry. In the first place, both the telecommunications and the energy industries provide, just like insurance and banking undertakings, services rather than ‘material goods’.

Secondly, similarly to the provision of banking and insurance services, telecommunications and energy can be defined as essential facilities denoting a *quasi*-social nature which is somehow difficult to be reconciled with competition law. As with the financial services sector, the provision of telecommunications and energy services traditionally used to be a state prerogative, and the two sectors were also subject to a process of liberalisation and integration similar to the ones which characterised the financial services sector⁵. Herein lies a key element of connection

⁵ The EU process of liberalization and integration of the energy markets started in the early nineties with the adoption of Directive 90/377 (*Council Directive 90/377/EEC of 29 June 1990 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users* [1990] OJ L176/1). Directive 90/377 was followed by a first wave of liberalization for the electricity and gas markets which comprised Directive 90/547 (*Council Directive 90/547/EEC of 29 October 1990 on the transit of electricity through transmission grids* [1991] OJL313/30, and Directive 91/296 (*Council Directive 91/296/EEC of 31 May 1991 on the transit of natural gas through grids* [1991] OJL147/37). The process of integration in the energy sector was subsequently integrated at the beginning of the new millennium through the enactment of a further series of directives which included Directive 2003/54 (*Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity* [2003] OJ176/37), and Directive 2003/55 (*Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas* [2003] OJ176/57). As for the telecommunication sector, the lion share of the process of integration of the European markets was enacted in the early 2000, with the adoption of a series of Directive whose aim was the harmonisation of the conditions of access, interconnection and provision of telecommunication services across the internal market. The most important directives are Directive 2002/19 (Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive) [2002] OJL 108/7, Directive 2002/21 (Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive)[2002] OJ L 108/33); Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), [2002] OJ L 108/51; Directive 2002/20/EC of the European Parliament and of the Council of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive) OJ L 108/37; Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) [2002] OJ L 201/35; Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communications networks and services [2002] OJ L 21. Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communications networks and services [2002] OJ L 249/21. The current

between these areas of the market; although one may claim that the economies of scale of the financial services market and the energy and telecommunication industries are radically different and at odds with one another, calling for a different solution in terms of market failure⁶, it is opinion of this author that despite such differences, some structural similarities render the comparison between these areas of the market valuable for the purpose of this thesis.

These structural similarities emerge from the nature of the services provided in these industries and their atavistic monopolistic nature. Just as with significant elements of the financial services sector, the energy and telecommunications industries were from the outset state prerogatives, and although the monopolistic aspects of the energy and telecommunication are admittedly more accentuated compared to the banking and insurance industries calling into question a different market failure problematic, similarities between these areas of the market do exist.

point of reference for the telecommunications sector is represented by Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009 amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and 2002/20/EC on the authorisation of electronic communications networks and services [2009] *OJ L* 337/37.

⁶ It is undeniable that the economics underpinnings of competition law in the energy and telecommunication sectors are under many aspects different from the financial services market. From an economic and regulatory perspective, when it comes to the energy and telecommunication sectors the market failure dilemma assumes a nature more linked to monopolistic issues, rather than information asymmetries which are more likely to arise in the financial services sector. Nevertheless, as emphasised in the above, monopolistic issues indeed arose also in relation to the financial services sector (at least in continental Europe), and similarities in terms of 'network structures' do exist between these different areas of the economy. Issues related to sector specific regulation, and the EU process of liberalisation also contribute to the built of a theoretical bridge which, going beyond the economic and market failure discrepancies, could prove to be a valuable tools for the analysis conducted in this thesis. On this point, see K. Talus; P. Kuoppamäki; "Relationship Between General Competition Laws and Sector Specific Energy Regulation" OGE 1 (2010), available at: www.ogel.org. Talus and Kuoppamäki point out that the sector specific regulation and the process of liberalisation of the energy sector are factors to be taken into account when it comes to competition regulation. This line of reasoning can be arguably equally apply to the telecommunication and financial services sectors rendering the comparison between those sector worthwhile for the purpose of this thesis.

The monopolistic nature of the financial services industry has been acknowledged by the doctrine⁷; the tendency of insurers to co-operate has been considered, thus, as one of the several aspects which render business insurance a “naturally monopolistic” activity.⁸

Moreover, in light of the recent global financial crisis the monopolistic nature of financial services was brought into the light again through the recent debate revolving around the concept “too big to fail.”⁹ The underlying idea of this debate would be that large financial services conglomerates become of such utmost economic/social importance, and that their collapse would have disastrous consequences for society as a whole. The UK state intervention in Northern Rock, RBS and other banks appears to corroborate the idea of the financial services sector as a sector characterised by a monopolistic inclination, backed by the state as single ultimate service provider of last resort.

Similarities do arise also from the progressive process of liberalisation which in the last two decades has characterised the financial, telecommunication and energy sectors in an analogous fashion. In all the industries at stake, this process of liberalisation has been characterised by a dichotomy arising from the need to enact an effective regulatory regime that enables the development of full competition,

⁷ See, *inter alia*, M. Faure, “*Insurance and competition law: balancing the conflicts*”, *above*, p. 9. See also J. Finsinger, “*European Integration of Insurance Markets. Preliminary but novel perspectives*”, Working Paper Universitat Luneburg Nr. 75, 1989, pp 70-72. The tendency of insurers to co-operate has been considered one of the several aspects which render business insurance a “naturally monopolistic”.

⁸ *Ibid.*, p.9. It is interesting to note that, till not long ago, in several Member States (e.g. Italy), the insurance industry was actually a State Monopoly.

⁹ For a detailed overview of the “Too big to fail” debate see, *inter alia*, Andrew Ross Sorkin “*Too Big to Fail: Inside the Battle to Save Wall Street*” Allen Lane 2009, Gary H. Stern, Ron J. Feldman “*Too big to fail: the hazards of bank bailouts*”, Brookings publishing 2004, and Douglas Darrell Evanoff, George G. Kaufman, “*Systemic financial crises*”, Kaufman 2004.

whilst effectively protecting other public interests¹⁰. The need to ensure effective competition was indeed developed *pari-passu* with the idea of granting a certain level of consumer protection.

Let us now consider this aspect as, in the author's opinion, it is extremely important in order to establish a theoretical linkage between the financial services sector and the energy and telecommunication industries. The wave of liberalisation of the financial services industry can be indeed compared with the process of privatisation of the telecommunication and energy sectors.

With the exception of the UK market where insurance and banking services were driven since the outset by private economic and entrepreneurial interests, in continental Europe the provision of financial services was initially subject to the monopolistic *longa manus* of governments just like what happened with the energy and telecommunication services. The advent of the European Community (now European Union) ignited a process of privatisation of these sectors which was characterised by the need to ensure full competition between undertakings operating in the market.

The need to ensure competition somehow clashed with the 'naturally monopolistic' nature of the financial, energy and telecommunication services. Nevertheless, this clash has led to a different regulatory approach of the sectors considered worthy of exploration for the purpose of this thesis.

The rationale for this lies with the fact that, as it will be appreciated in due course, the main controversial issues arising from the application of Art. 101 to the energy and telecommunication sector relate to the management and access to

¹⁰ OECD Reviews of Regulatory Reform, Regulatory Reform of the Telecommunications Sector, available at: <http://www.oecd.org/dataoecd/36/35/32482712.pdf>

network systems capable of being characterised as essential facilities. This is arguably the foremost similarity between the energy, telecommunications and the financial services sector.

The aforementioned process of liberalisation of the telecommunication and energy sector left open the need to reconcile the application of competition law with the presence of infrastructures to which access was restricted, built in order to provide services, similarly to what happened in the financial services industry. Strong similarities do exist between the energy, telecommunications and financial industries in the way that the creation of infrastructure networks is needed for the provision of services.

As will be unraveled in the course of this thesis, the similarities between network infrastructures in the telecommunication energy and banking sectors are very evident if the card payment systems are considered. Exactly as for the provision of gas/electricity and, for instance, telephone services, we shall discover that the provision of card payments is the outcome of the creation of a network infrastructure without which the provision of the service is virtually impossible¹¹.

Far from being confined to the banking sector, the similarities arguably extend also to the insurance sector. As will be established in the first part of this thesis, the provision of insurance services is based on the exchange of information on statistical data between large insurance associations. This system could indeed be defined as a network infrastructure not too dissimilar from the ones characterising the other industries taken into account¹². The existence of a sort of network infrastructure in the insurance industry appears to have been implicitly

¹¹ On this point see OECD, *“Competition and Regulation in Retail Banking”* (2006), available at <http://www.oecd.org/dataoecd/44/18/39753683.pdf>.

¹² See Chapter 3.

acknowledged by the Commission through the enactment of a block exemption for the exchange of information between insurance undertakings.

We shall promptly discover that the *raison d'être* for the block exemption in this area is the acknowledgment of the need for cooperation between insurance undertakings, which individually could not be in the position to create or have access to large statistical data necessary to determine premiums and face uncertainty.¹³ This arguably creates a network infrastructure which gives rise to the same competition concerns as those arising in the banking, energy and telecommunication sectors.

We are therefore dealing with different sectors of the market characterised by network structures which ignite similar antitrust anxieties in relation to the application of Art. 101. Above all, the monopolistic nature of these industries, the provision of 'quasi social services' of essential nature, the process of liberalisation which has characterised them in the last three decades, in conjunction with the idea of the creation of networks and infrastructures necessary to provide their services, create a theoretical linkage between the financial services industry and the telecommunication and energy sectors.

Despite we are dealing with different market failure issues, similar structures, and similar competition concerns, as it will be readily appreciated, do arise from the comparison between these areas of the market. It is opinion of this author that these elements of connection will render the parallel with the energy and telecommunication industries an invaluable tools to assess and corroborate the conclusions that will be reached in relation to the financial services sector.

¹³ See Chapter 3.

Part V, shall endeavour to consider whether the regulatory approach related to the application of Art.101 TFEU to the financial services sector should be consistent for both insurance and banking industries, or whether a diversified regulatory framework is justified.

Part VI will provide concluding remarks.

PART I – INTRO

1 The Application of the EU Competition law to the financial services sector: general issues

The Application of EU¹⁴ Competition law to the financial services sector: general issues

1.1 Banking and insurance services: two faces of the same coin?

Banking and insurance undertakings perform almost identical economic functions; both can be defined as financial intermediaries which receive money from private

¹⁴ With the entry into force of the Treaty of Lisbon on 1 December 2009, the EC has formally ceased to exist. Nevertheless, since this thesis was elaborated and largely refers to a period preceding the Treaty of Lisbon, reference is sometime made to “EC”, or “Community”, or to “EC” or “Community measures.”

individuals or companies in the form of deposits or premiums, and lend money to customers wishing to borrow.¹⁵

The literature has identified the nature of customers' claims as the real unique difference between the banks and insurance industry. If a bank depositor has the unconditional right to claim his money back either after a pre-set deadline or simply on demand, the same does not apply to a policyholder¹⁶. The claim of the latter is, indeed, conditional and can be exercised only when (and if) the event object of the insurance actually occurs¹⁷. This difference is anyway very subtle when it comes to life insurance where the demarking line between insurance and banking services seems to fade away, with the exemption of term insurance; life insurance policies provide, indeed, for both savings and credit mechanisms¹⁸.

Apart from similarities related to the nature and the function of the services provided, recent years have witnessed a closer linkage between insurance and banking industries, due to an evolutionary process triggered by financial innovations and the financial liberalisation of the internal market. More specifically, economic doctrine has identified four main phenomena that arguably consolidate the already

¹⁵ Economists have widely acknowledged the similarities in terms of economic functions between insurance and banking undertakings. See *inter alia*, T.F. Huertas and J.L. Silverman, "*The Banking and Insurance holidays of 1933*", Citicorp publications, available at: <http://www.h-net.org/~business/bhcweb/publications> Accessed on 3 July 2011.

See also NAIC, "*A Comparison of the Insurance and Banking Regulatory Frameworks for Identifying and Supervising Companies in Weakened Financial Condition*", Report of April 19, 2005, available at: <http://www.federalreserve.gov/boarddocs/staffreports/naicfrs/naicfrs.pdf>. Accessed on 3 July 2011. T.F. Huertas and J.L. Silverman have identified the sole difference between the banks and insurance industry in the nature of the customers' claims, and they point out that "a life insurance company performs some of the functions of a savings bank and, to a smaller degree, of a commercial bank." ("*The Banking and Insurance holidays of 1933*", above p.106).

¹⁶ See, T.F. Huertas and J.L. Silverman, "*The Banking and Insurance holidays of 1933*", above, p.101.

¹⁷ *Ibid.*

¹⁸ See T.F. Huertas and J.L. Silverman, above, p.108. In their comparative analysis, Huertas and J.L. Silverman point out that "a life insurance company performs some of the functions of a savings bank and, to a smaller degree, of a commercial bank."

existing synergies between insurance and banking businesses.¹⁹ *In primis*, it has been claimed that the “*desegmentation*” of finance which took place through the expansion of information technology has led to the availability of a larger number of insurance and banking products compared to the past, and to the creation of an unprecedented wave of competition between the insurance and banking industries.²⁰

Secondly, in the last few years a gradual process of “*marketisation*” of finance has seen financial markets thriving as vehicles for the provision of securities and derivatives²¹. Thirdly, the “*globalisation*” of finance has ignited a new growing trend of cross-border activities and mergers in the financial services sector.²²

Finally, the financial services market has also recently witnessed the phenomenon of so-called “*institutional repositioning*” of finance, whereby growing synergies saw the entry into the market of new multitasking players such as financial supermarkets (e.g. bankassurance).²³

Although the above phenomena have admittedly created a closer point of encounter between the banking and insurance industries, it has been argued that their impact on the banking sector was deeper compared to the insurance industry²⁴. This is due to the fact that except for reinsurance, the insurance industry is arguably

¹⁹ A detailed economic analysis of the factors which determined the amalgamation of the banking and insurance sectors has been carried by M. D. Knight in “*Meeting worlds? Insurance and banking*”, available at: <http://www.bis.org/speeches/sp050602.htm>. (Accessed 1 July 2011). The considerations that follows in this paragraph are based on the economic studies of M. D. Knight .

²⁰ See M. D. Knight in “*Meeting worlds? Insurance and banking*”, above, at p. 4.

²¹ *Ibid.* The marketisation of finance has, nevertheless, been recently contrived by the global financial crisis.

²² It is interesting to note that the globalization of the financial services industry did not nevertheless result into an increment of cross border provision of services (on this point see the Commission “*Report on the retail banking sector inquiry*”, sector inquiry under Art 17 of Regulation 1/2003 on retail banking (Final Report) [COM(2007) 33 final] at p. 45).

²³ See M. D. Knight in “*Meeting worlds? Insurance and banking*”, above, at p. 4.

²⁴ *Ibid.*

characterised by a less international or global dimension compared to banking industry.²⁵

Notwithstanding these differences, it is opinion of the author that similarities and growing areas of overlap between the insurance and banking sector arguably remain considerably more significant. The “financial” element of insurance products has indeed dramatically increased during the last few years²⁶. In this regard, economic studies have emphasised that the recent establishment of banking-insurance conglomerates was specifically devoted to “exploiting synergies in the battle for the retail asset holder”²⁷ through the exploitation of the insurance companies competitive edge in the “production” of insurance products in conjunction with the banks extensive retail networks.²⁸

Competition between the banking and insurance industries has also been dramatically intensified in the course of the last few years, especially as far as asset management and life insurance segments are concerned. Recently, the two industries have, indeed, intensively endeavored to attract the attention of new customers at a time characterised by a general lack of guarantees offered by national pension systems²⁹.

²⁵ See NAIC, “*A Comparison of the Insurance and Banking Regulatory Frameworks for Identifying and Supervising Companies in Weakened Financial Condition*”, above, p. 14. Some also claim that in respect to banks, the insurance industry is also distinguished by way of a more heterogeneous nature, with life and non-life segments belonging to two rather distinct types of business (on this point see M. D. Knight in “*Meeting worlds? Insurance and banking*”, above, at p. 4).

²⁶ *Ibid.* M. D. Knight provides the example of single premium unit-linked insurance policies, which, according to him, “compete directly with other financial products as resting places for household assets”.

²⁷ See M. D. Knight in “*Meeting worlds? Insurance and banking*”, above, at p. 4.

²⁸ *Ibid.* M. D. Knight points out that “as investors in and suppliers of guarantees, insurers have also become increasingly active in credit derivatives and structured finance products”.

²⁹ See M. D. Knight in “*Meeting worlds? Insurance and banking*”, above, at p. 6.

1.2 Competition law and the Financial Services Sector

Traditionally, and especially in continental Europe, the financial services sector used to be a state prerogative. Due to the *quasi*-social nature of financial services, in many Member States insurance services were subject to a state monopoly, and the banking system was heavily controlled by governments.³⁰

With the advent of the European Community (now after the entry into force of the Treaty of Lisbon, the European Union) the situation changed dramatically through the introduction of radical reforms of the financial services industry in several Member States. As a result, the previous government monopolistic approach was left behind in favour of heavy private sector involvement, which invariably enhanced competition igniting, at the same time, serious competition concerns.

Despite these radical changes, due to the recent global financial crisis the *quasi*-social nature of financial services was brought into the light again through the recent debate rotating around the concept “too big to fail.”³¹ The underlying idea of this debate would be that large financial services conglomerates become of such utmost economic importance, and that their collapse would have disastrous consequences for the society as a whole.

For the same reason, it has been traditionally claimed that the undertakings facing market complexities stemming out the financial services sector should be exempt from the application of competition law. This thesis, as it will be discovered

³⁰ *Inter alia*, Italy and France.

³¹ For a detailed overview of the “Too big to fail” debate see, *inter alia*, Andrew Ross Sorkin “*Too Big to Fail: Inside the Battle to Save Wall Street*” Allen Lane 2009, Gary H. Stern, Ron J. Feldman “*Too big to fail: the hazards of bank bailouts*”, Brookings publishing 2004, and Douglas Darrell Evanoff, George G. Kaufman, “*Systemic financial crises*”, Kaufman 2004.

in due course, strongly rebuts this line of reasoning, and advocates for a full exposure of the financial services sector to the application of Art 101. Nevertheless, far from being straightforward, the route to that conclusion will be long, winding and impervious.

Considered from an anti-trust perspective, the financial services sector gives rise, as a matter of fact, to many complexities. One of the main features of this industry is characterised by the fact that market members can assume the form of retailers, wholesalers, customers and suppliers, with the wholesale market capable of affecting retail customers indirectly.³²

Authors have correctly pointed out that insurers, banks and pension funds widely operate in the stock exchange or other securities markets, incurring trading costs which may be transferred to customers in terms of increments of products cost³³. Banks for their part operate through payment systems that they themselves created, and consequently need insurance, in the same way as insurance undertakings cannot detach themselves from banking services. Further, as previously mentioned, the dramatic increment of financial conglomerates lead to a scenario where different departments of the same undertaking can provide both insurance and banking services.

All this needs to be read in conjunction with the extremely complex inter-relationships between undertakings operating in the financial services industry. Especially if the worldwide scope of the field of wholesale financial services markets is considered, the high degree of sophistication of synergies among participants caused the financial services sector to be characterised by a very heterogeneous

³² See Faull and Nickpay, *"The EC Law of Competition"* OUP 2007, p. 636.

³³ See M. D. Knight in *"Meeting worlds? Insurance and banking"*, above, at p. 6.

nature. The global financial industry is thus very difficult to decode and to be clearly partitioned into banking and insurance services.

Above all, the role played by the financial services sector within the economy, is, to say the least, enormous. We are dealing with a sector of the market so important and complex, that it invariably needs to be subject to competition law in order to avoid market deficiencies and to ensure that an adequate framework of consumer protection is in place and fully functional.

That is the reason why, since the dawn of the European Community the Commission claimed that Articles 101 and 102 (former Articles 81 and 82) found full application to the financial services sector³⁴. Nevertheless, we had to wait until the early eighties to have the first confirmation of this; firstly in the *Zuchner*³⁵ case, the European Court of Justice dismissed any claims related to the idea of the banking sector falling outside the scope of application of Articles 101 and 102.

Subsequently, the Commission issued the very first two decisions relating to the insurance sector: *Nuovo CEGAM*³⁶ and *Fire Insurance*³⁷. The latter decision was appealed before the ECJ in the case *Verband der Sachversicherer*³⁸. In rejecting the applicant's (an association of insurers) claims that unrestrained competition in the insurance sector would enhance the risk of insolvency to the detriment of consumers, the Court emphasised that in the absence of distinctive rules, Articles 85 and 86 EC (now Articles 101 and 102 TFEU) found full application also to the insurance industry.

³⁴ See, *inter alia*, the "Commission Report on Competition Policy", 1972 (Vol. II) points 51-57.

³⁵ Case C-172/80 *Zuchner v Bayerische Vereinsbank AG* [1981] ECR 2021, 2030.

³⁶ *Nuovo CEGAM* [1984] OJ L99/29.

³⁷ *Fire Insurance* [1985] OJ L35/20.

³⁸ Case C-45/68 *Verband der Sacheversicherer* [1987] ECR 405, 449-452.

1.3 Features of banking and insurance arrangements: the importance of Art 101

The complexities arising from the application of the EU anti-trust rules to the financial services industry are, it will be readily appreciated, many. Different factors contribute to cast doubts on the methods of enforcement of competition rules in the banking and insurance industry.

In the first place, the entire financial services industry is characterised by atavistic features which appears to be, *prima facie*, incompatible with anti-trust regulatory frameworks. Horizontal agreements, for instance, represent a fundamental feature of both insurance and banking sectors; whilst it is allegedly essential for banks to co-operate in order to provide payment systems, for insurance firms horizontal agreements are deemed necessary in order to spread risks and face insolvency risks.

The anti-trust sensitivity of the forms of co-operation between undertakings in the financial services sector has been considerably exacerbated by the process of convergence between the insurance and banking industries ignited, as established before, by the information technology developments and by the creation of new bank-insurance conglomerates.

A further point of general relevance for the application of EU competition rules to the financial services sector is represented by the process of financial integration still on-going at European level. Various banking, insurance and investment services Directives have been implemented with the aim of creating a 'single passport' system aiming at facilitating the integration process of the community financial markets through the promotion of cross-border activities and the increase of competition. Despite Community efforts to establish a single market

for all financial services, both banking and insurance services are still mainly provided within the domestic sphere of individual Member States and cross-border competition is still very limited.³⁹

This scenario has been the object of scrutiny by the Commission, which already in the past pointed out that the close relationship characterising the financial services industry and the end consumers translates itself into very little cross-border integration, rendering it difficult to pass on the benefits of financial integration to consumers.⁴⁰

Further anti-trust issues are consequently ignited by the European Union 's desire to ensure a high degree of consumer protection. In applying the EU competition rules to the financial services sector, the Commission has, indeed, always placed particular emphasis on consumer protection concerns. Consumer protection is indeed one of the foremost teleological aspects of competition law, and a single market entails the need for a deeper protection of consumers in order to increase their confidence in the financial services sector⁴¹.

Despite the fact that anti-trust issues may indeed arise in relation to mergers and acquisitions, possible abuses of dominant position and state aid, it is opinion of the author that Art. 101 TFEU and the regulation of forms of horizontal co-operations represent the paramount and most intricate aspect of the application of the EU competition rules to the financial services sector⁴².

³⁹ See the Commission *"Inquiry into the European business insurance sector pursuant to Article 17 of Regulation 1/2003"*, above, p. 39. See also the Commission *"Inquiry into the European Retail banking sector"*, above, p. 87.

⁴⁰ See the Commission's Financial Integration Monitor, Commission press release IP/04/601.

⁴¹ See, *inter alia*, Commission Communication *"Financial services: enhancing consumer confidence"* COM(97) 309 final, 26 June 1997.

⁴² This thesis has been conceptually conceived in a period pre-financial crisis. Although issues related to state aid have been undoubtedly exacerbated by the recent crisis in the financial services sector, they fall outside the scope of analysis of this work which focuses its attention solely on Art. 101 TFEU.

As established in the above, both bank and insurance industries have been , as a matter of fact, historically characterised by intense forms of co-operation between undertakings, deemed to be necessary for the correct functioning of the financial services. On a general level, any agreement establishing homogeneous prices *vis-à-vis* consumers represents a blatant violation of Art. 101 giving rise to serious anti-trust concerns.

Nevertheless, as will be explored in this thesis, in the financial services sector the Commission has often allowed what the doctrine has correctly defined as forms of “horizontal agreements concerning a relevant cost element making up the final price c *vis-à-vis* customers”⁴³ through its decisions relating to interbank fees in payment systems and through the enactment of the block exemption for the insurance industry. Especially in consideration to the similarities between the nature of banking and insurance services, Art. 101 seems thus to represent a common thread between these two industries, posing at the same time interesting and rather intricate theological dilemmas which this thesis shall endeavour to answer: ought Art. 101 to apply to the financial services sector at all? If so, to what extent? Is there any justification for a block exemption in the insurance sector? Should the banking sector too benefit from a block exemption? This thesis shall endeavour to answer these questions in the quest for the identification of an ideal regulatory framework for forms of horizontal co-operation in the financial services sector.

⁴³ See Faull & Nikpay, “*The EC Law of Competition*” OUP 2007, p. 636.

PART II –ART.101 AND THE INSURANCE SECTOR

2 Setting the scene: the application of Art. 101 to the Insurance Sector: the early stages and the first Block Exemption Regulation

2.1 Introduction

This chapter aims at providing an analysis of the evolution of the application of EU competition law to the insurance sector.

Firstly, the general issues relating to the application of the EU competition rules to the insurance sector will be considered in conjunction with the evolution of the internal market for insurance undertakings. Subsequently, the analysis will shift on to the case law leading to the adoption of the various EU block exemption Regulations.

The current insurance block exemption regulatory framework will then be taken into account with a view to emphasising the main controversial issues arising from this piece of legislation (i.e. the need for a block exemption in the field of joint calculations or studies of risks and common coverage of specific risks). In particular, an attempt will be made to identify possible alternatives on the basis of arguments to be further unravelled in the course of this thesis.

Lastly, we shall endeavour to identify valid policy reasons for exposing the insurance industry to effective competition. This will be done with a view to theorising possible alternative forms of regulation, taking into account the concrete impact of the block exemption on the internal market in conjunction with comparative elements arising from the US scenario.

2.2 The evolution of the internal market for the insurance industry

The creation of an internal market for insurance undertakings has had quite a severe impact on the antitrust regulatory framework of the insurance industry. Any considerations related to the problematic application of Art. 101 to the insurance industry need, thus, to be considered in the context of the European Union efforts to

progressively harmonise the conditions for the provision of insurance services across Europe.

Authors have correctly acknowledged that the European harmonisation of insurance services (as well as the banking industry) has traditionally been an extremely arduous goal to achieve⁴⁴. A part from complexities arising from the atavistic differences between legal systems of different Member States, it has been indeed pointed out that the main difficulties arise from the necessity of going beyond the mere idea of facilitating the supply of services⁴⁵. This is due to the heavy regulatory framework which disciplines this area of the market, and which initially differed quite considerably between different Member States. In this regard, it has emphasised that in absence of a full harmonisation of the financial services sector, regulatory provisions such as solvency requirements may indeed have a severe impact on the cost of services, ultimately creating competition idiosyncrasies⁴⁶.

The biggest steps towards the harmonisation of the provision of insurance services were made in the early nineties, through the adoption of Council Directives 92/49/EEC⁴⁷ and 92/96/EEC.⁴⁸ These two Directives were adopted in order to promote the establishment of a single market in the insurance sector, and aimed at enacting a system for the authorisation and financial supervision of insurance

⁴⁴ See the considerations made on this point by R. Greaves, *“EC Competition Law, Banking and Insurance Services”*, Chancery Law Publishing, London 1991, p. 11.

⁴⁵ *Ibid.*

⁴⁶ *Ibid.*

⁴⁷ Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive), OJ L 228, 11.8.1992, p. 1–23. For a detailed overview of the early stages of the process of harmonisation of the insurance market, see R. Greaves, *“EC Competition Law, Banking and Insurance Services”*, above, pp. 41–60.

⁴⁸ Council Directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC (third life assurance Directive) OJ L 360, 9.12.1992, p. 1–27. Partially repealed by Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance OJ L 345, 19.12.2002, p. 1–51.

undertakings across the internal market. Under the regulatory framework established by the Directives, such authorisation is issued by the home Member State of the insurance undertaking concerned, enabling it to provide insurance services across the European Community; in order to provide insurance services in another Member State, the insurance undertaking must comply with the conditions for the insurance business laid down by the host Member State⁴⁹.

In spite of these efforts, the interpretation of the scope of the Treaty rules and of the provisions of the Insurance Directives was still surrounded by uncertainty, and these differences of interpretation seriously undermined the workings of the apparatus set up by the Third Directives. This scenario was thus likely to deter insurance undertakings from exercising the freedoms created by the Treaty which the Third Directives set out to promote.

In order to address such discrepancies, a series of new Directives⁵⁰ were enacted, among which, Directive 2002/83/EC concerning life assurance⁵¹, and Directive 2000/31/EC⁵² are of the utmost importance. Directive 2000/31/EC aimed at granting freedom of establishment and freedom to provide services with regard to the development of communication technology and its use in the insurance business; the development of electronic commerce in the insurance and financial business is

⁴⁹ See the Commission Interpretative Communication *“Freedom to provide services and the general good in the insurance sector”*, OJ 2000/C 43/03, p.3.

⁵⁰ E.g. Directive 2000/26/EC of the European Parliament and of the Council of 16 May 2000 on the approximation of the laws of the Member States relating to insurance against civil liability in respect of the use of motor vehicles and amending Council Directives 73/239/EEC and 88/357/EEC (Fourth motor insurance Directive) OJ L 181/65, and; Directive 2000/64/EC of the European Parliament and of the Council of 7 November 2000 amending Council Directives 85/611/EEC, 92/49/EEC, 92/96/EEC and 93/22/EEC as regards exchange of information with third countries OJ L 290/27.

⁵¹ Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance OJ L 345, 19.12.2002, p. 1–51, as further specified by two Adaptation Notices regarding the adaptation in line with inflation of certain amounts laid down in the Life and Non-Life Insurance Directives: a) Adaptation Notice 2006/C 194/07, and; b) Adaptation Notice 2009/C 41/01.

⁵² Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce') OJ L 178/1, 17.07.2000.

nowadays becoming more and more important and should eventually change the machinery for distributing insurance products in the European Union⁵³.

Far from being over, the process of integration of the European Union insurance markets is still ongoing and very much a work in progress. Despite the efforts and years of Directives, cross border provision of insurance services in the EU is virtually inexistent, especially in the field of mass insurance.⁵⁴ The uncertainty related to differing legal frameworks characterising individual Member States and the need for sales and claim settlement networks render easier for insurers to enter into another market through the acquisition of local existing insurers. This means that despite the presence of large insurance groups across the internal market, a full integration is yet to be achieved.⁵⁵

The incomplete process of harmonisation of the European Union insurance markets lays behind the decision of the Commission to launch a global investigation into the insurance sector in 2005⁵⁶. The aim of the investigation was to produce an overall assessment of the conditions of the insurance market, with specific reference to the mechanisms for market entry and distribution of insurance, and various forms of co-operation within the framework of insurance associations and in the context of coinsurance arrangements. The outcomes of the investigation were then published in September 2007⁵⁷, and a new Block Exemption Regulation in March 2010.⁵⁸

⁵³ Despite the enactment of Directive 2000/31/EC, the current legal framework for the single market in insurance is based on an apparatus within which consideration has not been given to the use of new technology for carrying out insurance business in the single market, and further work may possibly have to be carried out in this area.

⁵⁴ See the Commission “*Inquiry into the European business insurance sector pursuant to Article 17 of Regulation 1/2003*”, above, p. 45.

⁵⁵ *Ibid.* The situation is different when it comes to industrial and commercial insurance characterised by a higher degree of integration.

⁵⁶ See the Commission Decision for opening an “*Inquiry into the European business insurance sector pursuant to Article 17 of Regulation 1/2003*”, I P/05/719, of 13 June 2005.

⁵⁷ See the Commission “*Inquiry into the European business insurance sector pursuant to Article 17 of Regulation 1/2003*”, above.

As will be appreciated, the Report casts serious doubts related to the current EU regulatory framework and will represent a platform for discussion of paramount importance for the deliberations enshrined in this thesis.

2.3 The application of Article 101 to the insurance industry: general issues and background

Economic doctrine generally distinguishes the insurance industry from other sectors on the basis of the idea that the insurance business is primarily to be considered as an instrument of risk management.⁵⁹ It has been correctly noted that the peculiarity of the insurance industry indeed “lies in uncertainty”⁶⁰. In order to foresee the future cost of claims and thus to be in the position to determine the premium⁶¹, insurers need to rely on meaningful statistics concerning the “probability of realisation of the insured event and the foreseeable extent of the loss.”⁶²

Co-operation would therefore seem a natural and essential component of the insurance industry, and would play a paramount role in the provision and access to

⁵⁸ Commission Regulation (EU) No 267/2010 of 24 March 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of agreements, decisions and concerted practices in the insurance sector OJ L 83/1, of 30.3.2010.

⁵⁹ See G. Faure, T. Hartlief, *“Insurance and expanding systemic risks”*, OECD, Policy Issues in insurance, 2003, p.12. For a detailed analysis of the nature of the business insurance please see E.G. Vaughan and M. Vaughan, *“Fundamentals of Risk and Insurance”* 10th edition, John Wiley & Sons, 2008.

⁶⁰ See Faure, M., *“Insurance and competition law: balancing the conflicts”*, Global Issues in Insurance Regulation, London 17-18 April 2002, at p.6. Available at the following link: <http://www.nottingham.ac.uk/business/cris/papers/Grif%20%20Michael%20Faure.pdf>. (Accessed on 3 July 2011).

On this point see also G. Faure, R. Van Den Bergh, *“Competition on the European Market for Liability Insurance”*, 2002, p. 12. Available at : <http://arno.unimaas.nl>

⁶¹ The final price of insurance comprises the so-called ‘risk premium’ covering the cost of the insured product, a security charge, overheads and profit. The risk premium itself can be subdivided in two components: a) net premiums, aiming at covering the cost of the product insured on the basis of past statistical evidence (frequency and scale of claims) and b) a second component which levels the net premium either upwards or downwards according to predictions relating to the future (i.e. circumstances likely to happen capable of having an impact on the frequency or scale of claims).

⁶² See Faure, M., *“Insurance and competition law: balancing the conflicts”*, above, at p.6.

information sufficiently general to enable the calculation of average values, of crucial importance in order to determine insurance premiums.

More specifically, economists maintain that, especially when claims are relatively infrequent and risk categories are relatively numerous, large statistics identified on the basis of information exchange between insurance undertakings would allow better actuarial calculations based on internal claims experience.⁶³ This would result in a clear incentive for insurance firms either to merge or to cooperate in the pooling of claims⁶⁴.

Horizontal agreements would thus represent a fundamental feature of the insurance sector at any level: i.e., direct insurance (in which customers are the end users), reinsurance, whereby insurers are themselves the end users of policies subscribed with other insurers), and retrocession, through which providers of reinsurance obtain coverage for their own risks.

If horizontal agreements on joint determination of risk would seem an essential component of the business of direct insurance, co-operation in the form of co-insurance and reinsurance is also considered necessary to meet the needs of the modern insurance markets, whenever the entity of the risk to cover considerably exceeds the assets of an individual insurer.⁶⁵

In addition to the above forms of co-operation, a further peculiarity of the insurance industry would be represented by an overall lack of transparency, which would thwart the capacity of consumers to compare insurance policies offered by

⁶³ See G. Faure, T. Hartlief, *"Insurance and expanding systemic risks"*, above, p. 26.

⁶⁴ See G. Faure, R. Van Den Bergh, *"Competition on the European Market for Liability Insurance"*, above, p.23.

⁶⁵ See Faure, M., *"Insurance and competition law: balancing the conflicts"*, above, at p. 11. On this point see also G. Faure, T. Hartlief, *"Insurance and expanding systemic risks"*, above, p. 26. And M.Faure and R. Van Den Bergh "Restrictions of competition in the insurance markets and the applicability of EC Law, Kiklos Vol. 48, 1995 Fasc I, 65-85. Available at: <http://arno.unimaas.nl/show.cgi?fid=4627>. (Accessed on 3 July 2011).

competing insurers⁶⁶. This information deficiency would revert against the functioning of the insurance market mechanisms leading to inefficient results. That is the reason why standardization of policy terms has been traditionally considered as “the correct regulatory answer to an alleged market failure.”⁶⁷

Several aspects of the insurance business may thus seem to be characterised by an inherently monopolistic nature difficult to be reconciled with Art. 101 of the Treaty of Lisbon which prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market .

The application of Art. 101 TFEU to the insurance industry indeed poses serious questions; forms of co-operation in the form of joint determination of risk, co-insurance, reinsurance and the standardisation of policy terms represent the sort of quintessentially anti-competitive activities against which Art. 101 was specifically designed. It is not surprising, therefore, that the insurance industry has traditionally vehemently rejected the idea of being subject to the application of antitrust forms of regulation⁶⁸.

Are we facing a classic chicken and egg dilemma then? Not necessarily, as the way out can be found in Art. 101 itself. The third paragraph of this Article, as a matter of fact, allows the possibility of an exemption whereas anti-competitive agreements contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of

⁶⁶ See M. Faure, “*Insurance and Competition Law, Balancing the Conflicts*”, , p. 17. Available at: <http://www.nottingham.ac.uk>(accessed on 3 July 2011).

⁶⁷ See G. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 11.

⁶⁸ See the submissions to the Court of Justice made by insurance associations in the case *Verband der Sachversicherer*, Case C-45/68 *Verband der Sachversicherer* [1987] ECR 405, 449-452.

the resulting benefit, without resulting into the elimination of competition. Art. 101(3) represents the basis for the adoption of the Insurance Block Exemption Regulation that will be the subject of analysis in the following.

2.4 EU competition policy in the insurance sector: the early years

The evolution of EU competition policy in the insurance industry is a parallel phenomenon to the above analysed Community attempts at creating a single market for the provision of insurance services. The Commission had claimed from the outset that the EU Competition law framework found full application to the insurance industry.⁶⁹ During the eighties, *prima facie* endorsing the position of the Commission, the European Court of Justice confirmed that the insurance sector should be subject to the EU antitrust rules for the first time in the *Verband der Sachversicherer*⁷⁰ judgment. In spite of that declarations of principle, in *Verband der Sachversicherer* the Court also acknowledged the need for cooperation as one of the paramount features of the insurance industry⁷¹; as a consequence, the Commission was tasked with the chore of carefully weighing up the special features of the insurance sector with a view to granting, where suitable, individual exemptions on the basis of Article 101(3).⁷²

⁶⁹ As early as 1972, the Commission stated that the EC Treaty competition rules fully applied to the insurance industry (see, *inter alia*, the *Commission Report on Competition Policy*, 1972 (Vol. II) points 51-57).

⁷⁰ Case C-45/68 *Verband der Sachversicherer* [1987] ECR 405, 449-452. In *Verband der Sachversicherer*, the association of property insurers comprising all the insurers dealing with fire insurance in the German market failed to obtain clearance by the Commission in relation to its decision to recommend to its members specific increments of the premium rates. The aim of this recommendation was to re-establish stable and viable conditions in the industrial fire insurance and consequential loss insurance business.

⁷¹ *Ibid.*, at paragraph 12

⁷² Article 101 of the Treaty of Lisbon (prohibits all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. Article 101(3) provides for an exemption of any collusive practice capable of impairing competition insofar as it creates efficiencies that outweigh the restriction of competition,

The first two individual exemptions were granted at the end of the eighties, with the just mentioned *Verband der Sachversicherer*⁷³ and the Commission Decision *Nuovo Cegam*⁷⁴. The object of dispute in *Nuovo Cegam* was the founding agreement of the Italian association of engineering insurers Nuovo Consorzio Centrale Guasti alle Macchine ('New Central Engineering Insurers Association') ('Nuovo Cegam'). Under the founding agreement of the Association, a large number of direct insurers had established a mechanism by virtue of which it was possible to fix a common tariff of basic insurance premiums on the basis of an exchange of relevant information between the members of the Association. The Commission found that the rules and the arrangements establishing Nuovo Cegam resulted in a significant restriction of the competition between undertakings who, but for the Association, would have been in direct competition with one another⁷⁵.

An exemption was eventually obtained on the basis of Art.85(3) (now Art. 101 (3)) as Nuovo Cegam amended its power to fix tariffs of final premiums with the introduction of a common tariff of basic premiums which members of the Association were supposed to apply. By virtue of this new scenario, members of Nuovo Cegam were basically free to establish their own definitive premiums by adding to the basic premium a margin for commission, expenses or profit.

In *Verband der Sachversicherer*, the association of property insurers comprising all the insurers dealing with fire insurance in the German market did not obtain positive clearance by the Commission in relation to the decision of the consortium to recommend to its members specific increments of the premium rates

consumers obtain a fair share of those benefits, there are no less restrictive means of achieving the efficiencies, and competition is not eliminated altogether. Art. 101(3) constitutes the basis for the so-called 'Block Exemption Regulations' that have been introduced by the Commission over the years in order to grant exemption on a large scale to specific kinds of agreements.

⁷³ Commission Decision *Verband der Sachversicherer* 7/02/85 OJ L35/20.

⁷⁴ Commission Decision '*Nuovo Cegam*', 11/04/84 OJ L99/29.

⁷⁵ See Commission Decision '*Nuovo Cegam*', above, at paragraph 15.

(the aim of this recommendation was allegedly to re-establish stable and viable conditions in the industrial fire insurance and consequential loss insurance business)⁷⁶. In this case, the issue at stake was related to the so called gross premium risk, i.e., the final price charged by insurers for insurance products⁷⁷.

Unlike in *Nuovo Cegam*⁷⁸, the Commission was not prepared to grant an exemption to the agreement at issue. The distinction between the two cases lies in the fact that the agreement in *Nuovo Cegam* was focused on fixing a base premium, whereas the Verband der Sachversicherer recommendation established an increase of the final premium rates. Notwithstanding, the Commission pointed out that if members of the Verband der Sachversicherer organisation had been left free to compete in relation to the margin covering operating costs an exemption could have been granted exactly like in *Nuovo Cegam*⁷⁹.

In the early nineties, a new wave of individual exemptions stemmed from further Commission Decisions. In *Concordato Incendio*⁸⁰, an agreement comprising, *inter alia*, the calculation of ‘required’ premiums based on the statistics received for standard risks was granted an exemption.⁸¹ According to the Commission, as a general principle “...the existence of standard conditions makes it easier for consumers to compare the terms offered by various firms and come to a decision in full knowledge of the facts”⁸² so that they “can compare and choose not simply in relation to the commercial premium which is being

⁷⁶ This recommendation was an attempt to confine the negative performance of the fire insurance business which had caused heavy losses for German undertakings in the period across 1979-1980.

⁷⁷ For a definition of ‘insurance premium see footnote 52 at p35.

⁷⁸ For an overview of the *Nuovo Cegam* Decision see the above paragraph.

⁷⁹ Commission Decision *Verband der Sachversicherer*, at paragraph 16.

⁸⁰ Commission Decision, *Concordato Incendio* 1990 OJ L15/25.

⁸¹ *Concordato Italiano Rischi Industriali* (*Concordato Incendio*) was an association of Italian insurers which comprised 28 undertakings representing 50% of the Italian market for industrial fire insurance. The objective of the association was to improve the operation and quality of service to the policy holders provided by its members.

⁸² See Commission’s Decision, *Concordato Incendio*, above, at paragraph 23.

requested of them but also the extent of the coverage and all other services which an insurance company is supposed to provide, notably services as regards prevention and evaluation of damages”⁸³.

Furthermore, the Commission acknowledged that by recommending its members to adopt uniform net premium and standard policy conditions, an insurance association effectively obliges these members to notify any derogation from these standard conditions when “they are likely to affect the statistics”⁸⁴ as this “makes it possible to guarantee the uniformity of the statistics”⁸⁵. This notification requirement encouraged insurers to follow the recommendation.

Shortly after *Concordato Incendio*, with the decisions in *Teko*⁸⁶ and *Assurpol*⁸⁷ the Commission considered the possibility for exemption in relation to forms of co-operation in the field of co-insurance, agreements on co-insurance could benefit, according to the Commission, from exemption if pools allow participants to improve their knowledge of risks, create financial capacity and develop technical expertise in insuring the risks. Under these circumstances pools were deemed to produce results in substantial rationalisation and cost saving, enabling each participant to obtain a more diversified and balanced portfolio⁸⁸.

It has been interestingly noted that the exemption in TEKO showed a favourable attitude of the Commission towards re-insurance pools which enable members to underwrite re-insurance outside the pool, or to individually determine insurance premiums⁸⁹.

⁸³ See Commission’s Decision, *Concordato Incendio*, above, at paragraph 23.

⁸⁴ *Ibid.*, at paragraph 30.

⁸⁵ *Ibid.*, at paragraph 30.

⁸⁶ Commission’s Decision, *Technisches Kontor fuer die Maschinen-B-U-Versicherung (TEKO)*, 20/12/89 OJ L13/34.

⁸⁷ Commission’s Decision, *Assurpol*, 14/02/92, OJ L37/16.

⁸⁸ See Commission’s Decision, *Assurpol*, above, at paragraph 37.

⁸⁹ See the considerations made on this point by R. Greaves, “*EC Competition Law, Banking and Insurance Services*”, above, p. 94.

Overall, before the introduction of the first block exemption, the practice of pools was on a general level considered exemptible insofar as the task of creating statistical data or the magnitude of the risk insured went far beyond the capacity of individual insurers.

2.5 The first Block Exemption Regulation: Council Regulation 3932/92

After the first generation of insurance cases and individual exemptions analysed above, the Commission decided to introduce a block exemption through Council Regulation 3932/92.⁹⁰

The Regulation was adopted in order to allow the insurance industry to set up co-operation agreements, reducing at the same time the number of notifications and relative administrative workload involved.

The legal basis for the adoption of Regulation 3932/92 was Article 85(3) EC (now Art. 101 TFEU), by virtue of which all agreements satisfying its terms are fully exempted without the need for individual notification⁹¹.

The Council Regulation entitled the Commission to introduce a block exemption for agreements between insurance undertakings related to:(a) cooperation

⁹⁰ Commission Regulation (EEC) No 3932/92 of 21 December 1992 on the application of Article 85 (3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, 1992 OJ L398/7.

⁹¹ As outlined above (see Chapter one), an exemption can be granted to

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations of undertakings;
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

with respect to the establishment of common risk premium tariffs based on collectively ascertained statistics or the number of claims;(b) the establishment of common standard policy conditions;(c) the common coverage of certain types of risks; (e) the testing and acceptance of security devices.

The Regulation was divided into six titles establishing the requirements for insurance contracts covered by the exemption; insurance contracts falling outside the terms of the Regulation continued to require individual exemption.

2.5.1 (a) Cooperation with respect to the establishment of common risk premium tariffs

Article 2 of Regulation 3932/92 specified that the exemption applied only to agreements establishing common risk premium tariffs based on statistical data gathered over a period of years covering matters such as number of claims, number of individual risks covered, total amounts paid, etc.

Under Art. 2, exchanges of information between insurers for the purpose of setting down such tariffs ought to be “*neutral with respect to competition*”⁹²(this means that the exchange of information could not involve so-called business secrets). Furthermore, premium tariffs could not involve subjective factors relating to the insurance undertakings, e.g., financial and commercial costs, commissions, etc.⁹³

Title II of Regulation 3932/92 clearly incorporated the Commission Decisions *Nuovo Cegam* and *Concordato Incendio*⁹⁴, going, nevertheless further compared to the aforementioned decisions: the added value is enshrined in Article 2 of the Regulation which provided for a clear distinction between joint calculation of

⁹² See Commission Regulation (EEC) No 3932/92, above, Article 2.

⁹³ Ibid., Article 3.

⁹⁴ See Chapter 2 above.

net premiums (aiming at fixing the cost of insurance on the basis of the past experience) and o joint research concerning the impact of external factors on the scale of claims (allowing insurers to modulate the cost of insurance on the basis of future extraneous circumstances)⁹⁵.

It is interesting to note that prior to the enactment of the Regulation, in *Nuovo Cegam* and, to a lesser extent, *Concordato Incendio*, the Commission seemed to have reserved the benefit of the exemption only for collaboration among newcomers to a market or among incumbents operating in a market where the risk evaluation was of particularly difficult execution⁹⁶. Such distinctions were clearly not part of the block exemption introduced by Regulation 3932/92⁹⁷. Nevertheless, unlike in *Nuovo Cegam* and *Concordato Incendio*, it has been correctly noted that Regulation 3932/92 offered to the Commission the possibility to identify whether the cooperation between insurers went beyond the elaboration of genuine statistical data.⁹⁸

2.5.2 Standard policy conditions

⁹⁵ On this point see Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, Published in “Fordham Corporate Law Institute, 23rd Annual Conference On International Antitrust Law and Policy”, 18/10/96 New York. Available at: <http://ec.europa.eu/competition/speeches/text>(accessed on 1 July 2011).

With specific reference to concentration on net premiums, the Regulation clearly specified that the block exemption covered only ‘genuine’ statistical studies. See Commission Regulation (EEC) No 3932/92, above, Article 2 (a). Indeed the common “*calculation of the average cost of risk cover (pure premiums)*” was exemptible only whereas these premiums “*relate to identical or the calculation of the average cost of risk cover (pure premiums) or comparable risks in sufficient number to constitute a base which can be handled statistically and which will yield figures on (inter Alia) the number of claims (...), the number of individual risks insured (...), the total amounts paid or payable in respect of claims (...) and the total amount of capital insured for a particular observation period.*”

⁹⁶ On this point See Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above.

⁹⁷ Ibid..

⁹⁸ Ibid..

Standard policy conditions in line of principle used to fall under the block exemption as they were considered to “have the advantage of improving the comparability of cover for the consumer and of allowing risks to be classified more uniformly”⁹⁹.

However, they must not lead either to the standardization of products or to the creation of too captive a customer base; accordingly, the exemptions applied on condition that they were not binding, but served only as models. The Commission did recognise, however, that full standardisation of all conditions would not leave consumers much choice¹⁰⁰. This problem was addressed by the Regulation in two ways: on the one hand, as outlined above the Regulation specified that the agreed conditions remained purely illustrative¹⁰¹. On the other hand, the Regulation provided that the block exemption did not find application where the standard conditions contained (*inter alia*) clauses which had an adverse impact on policies.¹⁰²

⁹⁹ See Commission Regulation (EEC) No 3932/92, above, at Recital n.7.

¹⁰⁰ See Commission’s Decision, *Concordato Incendio*, above, at paragraph 23.

¹⁰¹ See Commission Regulation (EEC) No 3932/92, above, Article 6 (1). This requirement often remains idle in practice as a recommendation issued by a national association of undertakings always reflects a large consensus among its members. This seems to be the lesson to be learnt by *Concordato Incendio*. (on this point see Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above,).

¹⁰² The Regulation did not find application in case agreements between insurers used to: (a) *exclude from the cover losses normally relating to the class of insurance concerned, without indicating explicitly that each insurer remains free to extend the cover to such events;*
(b) *make the cover of certain risks subject to specific conditions, without indicating explicitly that each insurer remains free to waive them;*
(c) *impose comprehensive cover including risks to which a significant number of policyholders is not simultaneously exposed, without indicating explicitly that each insurer remains free to propose separate cover;*
(d) *indicate the amount of the cover or the part which the policyholder must pay himself (the ‘excess’);*
(e) *allow the insurer to maintain the policy in the event that he cancels part of the cover, increases the premium without the risk or the scope of the cover being changed (without prejudice to indexation clauses), or otherwise alters the policy conditions without the express consent of the policyholder;*
(f) *allow the insurer to modify the term of the policy without the express consent of the policyholder;*
(g) *impose on the policyholder in the non-life assurance sector a contract period of more than three years;*
(h) *impose a renewal period of more than one year where the policy is automatically renewed unless notice is given upon the expiry of a given period;*
(i) *require the policyholder to agree to the reinstatement of a policy which has been suspended on account of the disappearance of the insured risk, if he is once again exposed to a risk of the same nature;*
(j) *require the policyholder to obtain cover from the same insurer for different risks;*

2.5.3 Common coverage of certain types of risk

Title IV of Regulation 3932/92 (Article 10 to 13) specified the conditions under which institutionalised (as opposed to ad hoc) co-insurance and co-reinsurance pools were automatically exempted.

The block exemption used to cover the setting up and operation of co-insurance and reinsurance groups as defined in Article 10 of the Regulation, but only on condition that the group's market share did not exceed 10% in case of co-insurance and 15% for reinsurance. The maximum for co-insurance increased to 15% in presence of a statutory obligation to insure the risks covered by the co-insurance and where these are catastrophe risks¹⁰³.

The same contract clauses enshrined in the pooling agreements which the Commission exempt in *TEKO* and *Assurpol* re-emerged in the block exemption Regulation as automatically exempted clauses.¹⁰⁴

(k) require the policyholder, in the event of disposal of the object of insurance, to make the acquirer take over the insurance policy.

¹⁰³ It deserves to be noted that the 10% and 15% market shares used to comprise all products underwritten by the pool participants, including those underwritten outside the pool. The grounds for this division were rooted in the way the Commission traditionally approached joint ventures. When parent companies remained active on the same market as the joint venture, the Commission took the view that this joint venture distorts competition between the parents because "they can be expected to align their commercial policy on that of the joint venture". This is often referred to as "the spill over effect" (the aforementioned points have been made by Luc Gyselen, in "*EU antitrust Law in the Area of Financial Services*", above). Article 11 of Regulation 3932/92 used to set down the spill over effect to the co-insurance or co-reinsurance pools: as a consequence, Luc Gyselen points out that the block exemption was inapplicable in cases where the insurance products into the pool by participants accounted for less than 10% and 15%, but where all the products underwritten by them exceed these thresholds. Article 11 of the Regulation set the standards above: whether in practice there was a substantial dissimilarity between the volume of business that the participants bring into the pool and that of all business underwritten by them (individually or through the pool) is a different matter. Experience tends to suggest that for normal risks a discrepancy is likely to occur more often than for aggravated or catastrophic risks (on this point see Luc Gyselen, "*EU antitrust Law in the Area of Financial Services*", above; see also G. Faure, T. Hartlief, "*Insurance and expanding systemic risks*", above).

¹⁰⁴ On this point see Luc Gyselen, "*EU antitrust Law in the Area of Financial Services*", above. See Commission Regulation (EEC) No 3932/92, above, Article 10 and Articles 12-13. The rationale which lies beneath the different market shares was to be found in the fact that the mechanism of co-insurance requires the application by the pool participants of not only uniform conditions, but also of identical gross premiums, whereas co-reinsurers only need to jointly determine the risk premium and the co-reinsurance premium (i.e. the co-reinsurance cost). In other words, price competition is still

Under Regulation 3932/92, the block exemption used to cover agreements which had as their object the setting-up and operation of groups of insurance undertakings or of insurance undertakings and reinsurance undertakings for the common coverage of a specific category of risks in the form of co-insurance or co-reinsurance.¹⁰⁵

The exemption of the common coverage of risks provided by Regulation 3932/92 was rather wide in scope. Common coverage agreements could determine, *inter alia*, the nature and characteristics of the risks covered by the co-insurance or co-reinsurance, the conditions governing admission to the group, and the individual own-account shares of the participants in the risks co-insured or co-reinsured¹⁰⁶.

Under the first block exemption, insurers were also allowed to establish joint settlement procedures (in co-reinsurance only for claims “exceeding the specified amount”¹⁰⁷), and they were further allowed to fix joint-reinsurance (of the co-insured risks) or joint retrocession (of co-reinsured risks)¹⁰⁸.

Finally, insurers were allowed to back up such joint re-insurance or joint retrocession through the imposition of a ban on themselves to re-insure (respectively retrocede) their individual share in the co-insurance (respectively co-reinsurance). In case of co-reinsurance, they were allowed to provide for an additional ban to reinsure their individual retention¹⁰⁹.

2.5.4 Security Devices

present in the case of co-reinsurance, but eliminated in the case of co-insurance. On this point see also Faull & Nikpay, *above*, p. 638.

¹⁰⁵ See Commission Regulation (EEC) No 3932/92, *above*, Art. 10.

¹⁰⁶ *Ibid.*, Art. 10.

¹⁰⁷ See Commission Regulation (EEC) No 3932/92, *above*, Article 13.

¹⁰⁸ *Ibid.*, Art. 13.

¹⁰⁹ *Ibid.*, at Art. 13.

Under title V, the exemption covered only agreements between insurers applying to the setting of objective and non-discriminatory technical standards relating to the approval of security devices and their installation and the adoption of common standards for the approval of installation and maintenance contracts.

The conditions for exemption of such agreements were laid down by Article 9 of the Regulation¹¹⁰. As will be established in the next Chapter, together with the regime related to standard policy conditions, this area has recently been the object of significant changes introduced by the current block exemption regime.

¹¹⁰ See Commission Regulation (EEC) No 3932/92, above, Title V. (a) the technical specifications and compliance assessment procedures are precise, technically justified and in proportion to the performance to be attained by the security device concerned;
(b) the rules for the evaluation of installation undertakings and maintenance undertakings are objective, relate to their technical competence and are applied in a non-discriminatory manner;
(c) such specifications and rules are established and distributed with an accompanying statement that insurance undertakings are free to accept for insurance, on whatever terms and conditions they wish, other security devices or installation and maintenance undertakings which do not comply with these technical specifications or rules;
(d) such specifications and rules are provided simply upon request to any interested person;
(e) any lists of security devices and installation and maintenance undertakings compliant with specifications include a classification based on the level of performance obtained;
(f) a request for an assessment may be submitted at any time by any applicant;
(g) the evaluation of conformity does not impose on the applicant any expenses that are disproportionate to the costs of the approval procedure;
(h) the devices and installation undertakings and maintenance undertakings that meet the assessment criteria are certified to this effect in a non-discriminatory manner within a period of six months of the date of application, except where technical considerations justify a reasonable additional period;
(i) the fact of compliance or approval is certified in writing;
(j) the grounds for a refusal to issue the certificate of compliance are given in writing by attaching a duplicate copy of the records of the tests and controls that have been carried out;
(k) the grounds for a refusal to take into account a request for assessment are provided in writing; and
(l) the specifications and rules are applied by bodies accredited to norms in the series EN 45 000 and EN ISO/IEC 17025¹¹⁰.

3 The Recent and Current Scenarios: Regulation 358/2003 and the Current Block Exemption Regulation¹¹¹

3.1 Regulation 358/2003

Six years after the entry into force of Regulation 3932/92, the European Commission released a Report on the operation of the new block exemption regulatory framework¹¹². The aim of the Report was to assess the practical impact of

¹¹¹ This Chapter is largely based on extracts of the considerations expressed by the author in the article Lista A. "Stairway to Competition Heaven, or Highway to Hell: What Next for Insurance Competition Regulation?", Journal of Business Law, Issue I, 2011, pp.1-27.

¹¹² The Report from the Commission to the Council and the European Parliament on the operation of Commission Regulation 3932/92, COM (1999)192 final.

the exemption in the insurance sector with the view to operate changes and review Regulation 3932/92¹¹³.

In the Report, the Commission outlined the difficulties arising in determining whether co-operation agreements on premiums remain within the limits of what is necessary for statistical purposes¹¹⁴; the analysis of such agreements focused mostly on the concrete effects of such agreements on the pricing policy that insurers apply to their customers: in case commercial premiums differ substantially, the agreement was deemed not to cause appreciable detriment to competition.

Another important point outlined in the Report was related to standard policy conditions; the Commission mainly concentrated its attention on “black” clauses (in principle prohibited) such as that excluding certain risks from cover. Under Regulation 3932/92, standard policy conditions were authorised provided that they were not binding on their members, and the Commission emphasised the need for stricter controls aiming at ensuring compliance with the requirements of the Regulation.¹¹⁵

With such proposals in the pipeline, the next block exemption regulatory framework,¹¹⁶ Regulation 358/2003, entered into force on 1 April 2003 aiming to update Regulation 3932/92 and render it more ‘user friendly’.

Those changes came at a time of increasing focus by the competition authorities on financial services and when the insurance sector was obliged to

¹¹³ The Report on the operation of Commission Regulation 3932/92 led to the adoption of the new Commission Regulation (EC) No 358/2003 of 27 February 2003 on the application of Article 101(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector.

¹¹⁴ See the Report from the Commission to the Council and the European Parliament on the operation of Commission Regulation 3932/92, above p.6.

¹¹⁵ See the Report from the Commission to the Council and the European Parliament on the operation of Commission Regulation 3932/92, above p.14.

¹¹⁶ Commission Regulation (EC) No 358/2003 of 27 February 2003 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector.

observe compliance procedures in this area of law far more strictly compared to the past¹¹⁷.

Regulation 358/2003 was in many respects similar to the previous regime; it was designed under the enabling Council Regulation of 1991 (the same Regulation which enabled the adoption of the 1992 regulation) and it continued to cover the same types of agreement covered by Regulation 3932/92, i.e. (1) joint calculation and studies of risks; (2) the drawing up of standard policy conditions for direct insurance; (3) pooling arrangements (co-insurance groups and co-reinsurance groups); and (4) common rules for approving security devices. In all cases, there were strict conditions to be met; the exemption for insurance pools was broadened with higher market share thresholds. Other exemptions remained very similar to the old regime, but were narrowed down in various respects.

Contrary to the previous regime and in line with Block Exemption Regulations relating to other sectors¹¹⁸, Regulation 358/2003 subjected the possibility of an exemption to the absence of a series of clauses enshrined in a ‘black list’ which appeared for the very first time in the text of the Regulation.¹¹⁹

¹¹⁷ In 2001, the European Commission imposed fines of over £1 billion on companies which infringed competition law; individual companies have been fined hundreds of millions of Euro.

¹¹⁸ See, for instance, Commission Regulation (EC) No 772/2004 of 27 April 2004 on the application of Article 81(3) of the Treaty to categories of technology transfer agreements O J L 123/11, or Commission Regulation (EC) No 1400/2002 of 31 July 2002 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices in the motor vehicle sector O J L 203/30.

¹¹⁹ The idea of introducing block exemption systems based on ‘black lists’ clauses came at a time of increased focus by the competition authorities on financial services and as the insurance sector, for the first time, moved to adopt compliance procedures in this area. In 2001, during the gestation period of Regulation 358/2003, the European Commission imposed fines of over £1 billion on companies found to have infringed competition law; individual companies have been fined hundreds of millions of Euro.

3.1.1 *The exemption of joint calculations and studies of risks under Regulation 358/2003*

Regulation 358/2003 used to lay emphasis on the importance for insurers of having accurate information about the risks which they insure, including future risks; consequently, an exemption in relation to certain types of exchange of statistical information and joint calculation of risks was on that basis granted.¹²⁰

The reliability of joint calculations, tables and studies was believed to become greater as the amount of statistics on which they are based is increased¹²¹. Insurers with high market shares may generate sufficient statistics internally to be able to make reliable calculations, but those with small market shares will not be able to do so, much less new entrants.¹²² According to the Commission, inclusivity in such joint calculations, tables and studies of information from all insurers on a market, including large ones, promotes competition by helping smaller insurers, and facilitating market entry for new undertakings.¹²³

The exemption of joint activity in this area was nevertheless subject to two specific conditions: exactly as per Regulation 3932/92¹²⁴, joint calculations, tables and studies could benefit from the exemption as long as they were based on the assembly of data, spread over a number of risk-years chosen as an observation period.¹²⁵ The second condition for the block exemption was enshrined in Article 3(1) whereby the exemptions used to apply on condition that the calculations, tables

¹²⁰ See Commission Regulation (EC) No 358/2003, *above*, recital 12.

¹²¹ *Ibid.* recital 13.

¹²² *Ibid.*

¹²³ *Ibid.*

¹²⁴ See Commission Regulation (EEC) No 3932/92, *above*, Art.2.

¹²⁵ The statistical data must relate to identical or comparable risks in sufficient number to constitute a base which can be handled statistically and which will yield figures on (*inter alia*): (i) the number of claims during the said period, (ii) the number of individual risks insured in each risk-year of the chosen observation period, (iii) the total amounts paid or payable in respect of claims arisen during the said period (iv) the total amount of capital insured for each risk-year during the chosen observation period (Article 3(1)).

or study results were made available on reasonable and non-discriminatory terms, to any insurance undertaking requesting a copy of them.¹²⁶

This sort of disclosure requirement was an innovative element introduced by Regulation 358/2003 and, as it will be readily appreciated, was going to be further developed by the new block exemption regime entered into force in March 2010. For the moment, it deserves to be emphasised that the requirement for access to compilation of studies related to risks by any insurance undertaking primarily aimed at protecting and favour the entry into the market of new insurers.

Clearly, the Commission realised at the time of the introduction of Regulation 358/2003 the potential ‘boomerang effect’ of allowing joint calculation of risks. If on the one hand the rationale for a block exemption in this area was to aid insurers to reduce costs, on the other hand in absence of any disclosure requirements association of insurers well established in the market were in the position to use the shield of the block exemption *vis-à-vis* new entrants in the market.

3.1.2 Common coverage of certain types of risks (pools)

Regulation 358/2003 used to subject the exemption of pools to thresholds related to the parties’ market shares: co-insurance or co-reinsurance groups (pools) were allowed on condition that the combined market shares of their members did not

¹²⁶ This includes insurance undertakings which were not active on the geographical or product market to which those calculations, tables or study results refer. The Commission indicated that fees charged for access to studies to insurance firms which did not contribute to the studies could not be so high as to constitute a barrier to entry onto the market. The exemption did not cover agreements obliging undertakings not to use calculations or tables that differ from the ones available to all insurance undertakings or to depart from the results enshrined in such calculations. See Commission Regulation (EC) No 358/2003, *above*, I Article 4. The aim of this Article is clear: undertakings could jointly calculate risks, but they could not impose such calculations on external competitors which are therefore free to jointly or severally carry out their own studies and calculations. Moreover, the condition for the block exemption laid down by Article 3(1) required that calculations and tables must include as detailed a breakdown of the available statistics as was actuarially adequate.

exceed (a) in the case of co-insurance pools, 20% of the relevant market; (b) in the case of co-reinsurance pools, 25% of the relevant market.¹²⁷

Considering the extent of the thresholds imposed by Regulation 358/2003, the scope of application of the exemption of pools was rather broad, considerably broader compared to Regulation 3932/92¹²⁸. This liberal approach was enhanced by the fact that the exemption did not provide for a market share threshold for insurance pools which were newly created (i.e. after 1 April 2003, the date of the entry into force of Regulation 358/2003) in order to cover a new risk, for the first three years of their existence.¹²⁹

On a general level, pools did not infringe Article 101(1) if, in the absence of the group/pool in question, none or only one of the members of the group were able to offer the category of insurance concerned (even if other companies or pools do supply that category of insurance).¹³⁰ However, where the subscription capacity of the group was such that it could have been replaced by at least two competing groups, the group may restrict competition within the meaning of Article 85 (1) (now 101(1)) depending on the level of its market power; hence the need for market share thresholds.¹³¹

¹²⁷ See Commission Regulation (EC) No 358/2003, *above*, Article 7 (2). The market share was calculated on the basis of the gross premium income; in case the gross premium income data was not available, estimates based on other reliable market information, including insurance cover provided or insured risk value, could have been used to establish the market share of the undertaking concerned; Article 7 (3).

¹²⁸ See Commission Regulation (EEC) No 3932/92, *above*, Art.11(1).

¹²⁹ See Commission Regulation (EC) No 358/2003, *above*, Article 7 (1). New risks were defined by Recital 20 of the Regulation as risks that did not previously exist. More specifically, a new risk, by its nature, requires an entirely new insurance product and cannot be covered by additions or modifications to an existing insurance product. This excluded risks that previously existed but were not insured. Moreover, a risk whose nature is subject to significant changes (e.g. terrorism) would not be a new risk, even if there was a considerable increase in terrorism activity. Overall, the Commission indicated the areas for which pools were most often created as being aviation, nuclear and environmental (Recital 17).

¹³⁰ *Ibid.*, Recital 21.

¹³¹ *Ibid.*, recital 22. These considerations clearly incorporate the line of reasoning adopted by the Commission in the cases *Teko Technisches Kontor fuer die Maschinen-B-U-Versicherung (TEKO)*,

3.1.3 Standard policy conditions

In line with the previous regime, under Regulation 358/2003, standard policy conditions were exempted if they were established and distributed with an explicit statement that they are non-binding and that their use is not in any way recommended. In addition, the Regulation expressly required that participating undertakings were free to offer different policy conditions to their customers, with the conditions being accessible to any interested person and provided upon request.¹³² Finally, the exemption applied only on condition that the non-binding models were established and distributed only by way of guidance.¹³³

20/12/89 OJ L13/34, and *Assurpol* 14/02/92, OJ L37/16., where the Commission considered that agreements on co-insurance can benefit from exemption if pools allow participants to improve their knowledge of risks, create financial capacity and develop technical expertise in insuring the risks. Under these circumstances, pools result in substantial rationalisation and cost savings, enabling each participant to obtain a more diversified and balanced portfolio.

In addition to the block exemption, the Commission still explicitly recognises that pools may otherwise benefit from an individual exemption, stating that as many insurance markets are constantly evolving, an individual analysis would be necessary to determine whether or not the conditions for exemption laid down in Article 101(3) are met.

¹³² See Commission Regulation (EC) No 358/2003, *above*, Article 5 (1).

¹³³ *Ibid.*, Article 5 (2). Such condition seems to imply per se a lack of conviction on the Commission's part in relation to the validity of a block exemption as an effective means to ensure an effective access to information by consumers. From this perspective, civil law remedies against unfair policy conditions could represent a more suitable alternative. The Regulation contained a long list of 'black clauses' whereby the exemption did not find application when standard policy conditions contained clauses which, *inter alia*, provided for indications of the level of commercial premiums, indicated the amount of the cover or the part which the policyholder must pay himself (the 'excess'), imposed comprehensive cover including risks to which a significant number of policyholders are not simultaneously exposed, etc. More specifically, Art. 6 used to prohibit agreements on standard policy conditions which contain the following clauses: (a) contained any indication of the level of commercial premiums; (b) indicate the amount of the cover or the part which the policyholder must pay himself (the 'excess'); (c) imposed comprehensive cover including risks to which a significant number of policyholders are not simultaneously exposed; (d) allow the insurer to maintain the policy in the event that he cancels part of the cover, increases the premium without the risk or the scope of the cover being changed (without prejudice to indexation clauses), or otherwise alters the policy conditions without the express consent of the policyholder; (e) allow the insurer to modify the term of the policy without the express consent of the policyholder; (f) impose on the policyholder in the non-life assurance sector a contract period of more than three years; (g) impose a renewal period of more than one year where the policy is automatically renewed unless notice is given upon the expiry of a given period; (h) require the policyholder to agree to the reinstatement of a policy which has been suspended on account of the disappearance of the insured risk, if he is once again exposed to a risk of the same nature; (i) require the policyholder to obtain cover from the same

3.1.4 Joint determination of approved safety equipment

Under Regulation 358/2003, agreements between insurers on technical specifications for security equipment still used to benefit from block exemption.

In the course of preparations of Regulation 358/2003, the original idea of the Commission was to introduce a new condition for exemption of agreements between insurers on approved security equipment.¹³⁴ According to a proposed draft, the condition for exemption was to be that technical specifications, rules, procedures or codes of practice adopted by national associations of insurance or reinsurance undertakings in other Member States must have been explicitly recognised as equally valid by an association or associations of insurance or reinsurance undertakings in one or several Member States.¹³⁵ The same applied to any approval of a security device or installing and maintenance undertaking issued by an association of insurance or reinsurance undertakings in another Member State.¹³⁶

Under Regulation 358/2003, security devices were exempt insofar as the rules for the evaluation of installation undertakings and maintenance undertakings were objective, relate to their technical competence and are applied in a non-discriminatory manner¹³⁷. Such specifications and rules were required to be established and distributed with an accompanying statement that insurance undertakings were free to accept for insurance, on whatever terms and conditions

insurer for different risks; (j) require the policyholder, in the event of disposal of the object of insurance, to make the acquirer take over the insurance policy; (k) exclude or limit the cover of a risk if the policyholder uses security devices, or installing or maintenance undertakings, which are not approved in accordance with the relevant specifications agreed by an association or associations of insurers in one or several other Member States or at the European level”

¹³⁴ *Ibid.*

¹³⁵ See the proposed Commission Regulation (EC) No 358/2003, *above*, Article 9 (n).

¹³⁶ *Ibid.*, Article 9 (m). Moreover, the draft Regulation did not offer any exemption to technical specifications, rules, procedures or codes of practice adopted by an association or associations of insurance or reinsurance undertakings in one or several Member States if there was equivalent technical specifications, rules, procedures or codes of practice at European level.

¹³⁷ *Ibid.*, Article 9 (b).

they wish, other security devices or installation and maintenance undertakings which do not comply with these technical specifications or rules.¹³⁸

3.2 The Current Regime: Regulation 267/2010

The introduction of the current Block Exemption Regulation¹³⁹ was, yet again, to be preceded by a Commission Report, the *Report on the Insurance Block Exemption*¹⁴⁰. In the Report, the Commission came to the preliminary conclusion that agreements on cooperation in the area of joint calculations, tables and studies should be facilitated and that the block exemption in this area deserved continuity of application. The same considerations arose in relation to insurance pools.

Finally, it was maintained that two of the constitutive elements of the old regime, i.e. standard policy conditions and security devices, should have been removed *tout court* from the scope of the block exemption, whereas the exchange of statistical information for risk calculation and the creation of insurance pools should continue to benefit from antitrust immunity.

In line with what was pre-announced by the Report on the Insurance Block Exemption, the scope of application of the Block Exemption was dramatically reduced.

After almost 20 years of granted antitrust bonanza, the insurance industry is thus at the dawn of a new era. Starting from March 2010, only agreements on joint compilations, tables and studies of risk and co and re-insurance pools continue to

¹³⁸ *Ibid*, Article 9 (c).

¹³⁹ Commission Regulation (EU) No 267/2010 of 24 March 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of agreements, decisions and concerted practices in the insurance sector (OJ L 83/1, 30.3.2010).

¹⁴⁰ Commission Report on the Insurance Block Exemption, 24/03/2009. Available at: http://ec.europa.eu/competition/sectors/financial_services/insurance_ber_report_ep.pdf

benefit from a general exemption, whereas agreements on standard policy conditions and on minimum specifications for security devices are no longer sheltered by the shield of a block exemption, and are consequently fully exposed to the application of Art. 101 of the Lisbon Treaty.

3.2.1 The new regime for Joint compilations, tables and studies under Regulation 267/2010

The block exemption continues to cover agreements on joint compilations, tables and studies, as the Commission still acknowledges the importance of co-operation between insurance undertakings in this area¹⁴¹.

Nevertheless, there is a significant change compared to the previous regime; the new block exemption crucially requires calculations and studies to be made available not only to all insurance companies, but also to consumer and customer organisations which request them¹⁴². This represents a welcome change, as the requirement of disclosure may work as a deterrent for insurance undertakings to avoid forms of information exchanges related to the actual insurance premium. Nevertheless, if on the one hand this requirement enhanced the obligation to share information beyond the previous regime, single individuals are not in the position to have access to these data. Further, the requirement enshrined in Art. 3(2) e is subject to an exemption on the basis of public security issues¹⁴³, and the concept of public security remains yet to be clarified.

¹⁴¹ *Ibid.*, recital n. 9.

¹⁴² *Ibid.*, Art. 3(2) e. Single individuals are not in the position to have access to these data. Further, the requirement enshrined in Art. 3(2) e is subject to an exemption non the basis of public security issues.

¹⁴³ *Ibid.*, Art. 3(2) d.

3.2.2 *The new regime for co and re-insurance pools*

The current regime retains the block exemption for pools that cover “new risks” and for other pools subject to certain market share thresholds.

In line with the previous regime, pools covering new risks are exempted for a three years period, regardless of the participants’ market share¹⁴⁴. The risk must be genuinely new or, exceptionally, a risk the nature of which has, on the basis of an objective analysis, changed so materially that it is not possible to know in advance what subscription capacity is necessary in order to cover such a risk¹⁴⁵. The concept of risk changed on the basis of object criteria is new and will have to be further elaborated. Nevertheless, this new concept may represent an important tool for the Commission in order to assess the effective necessity of the coverage of specific risks through pools.

There are also changes in respect of pools covering existing risks. If under the previous regime market share thresholds were considered in relation to the turnover of the pool, from now on, the possibility of benefiting from the exemption will depend on the turnover of all participating companies on the relevant market, regardless of the fact that the turnover is achieved inside or outside the pool¹⁴⁶. This narrows down the scope of application of the exemption considerably, and arguably will ignite a certain degree of uncertainty. This new scenario would be, in fact, particularly delicate for larger insurers, as uncertainty shall inevitably arise in relation to the calculation of market shares for all undertakings participating in the pool.

¹⁴⁴ *Ibid.*, Art. 6 (1).

¹⁴⁵ *Ibid.*, Art. 1(6) b.

¹⁴⁶ *Ibid.*, Art. 6 (3) c.

For the first time, *ad hoc* co-insurance and co-reinsurance agreements will fall outside the application of the block exemption¹⁴⁷. *Ad-hoc* co-reinsurance agreements on the subscription market, are defined by the Regulation as agreements whereby a certain part of a given risk is covered by a lead insurer and the remaining part of this risk is covered by follow insurers who are then invited to cover that remainder in order either to a) reinsure mutually all or part of their liabilities in respect of a specified risk category; or b) incidentally accept, in the name and on behalf of all the participants, the reinsurance of the same category of risks¹⁴⁸. This means that insurance undertakings participating in *ad hoc* agreements will be fully exposed to the EU competition rules.

Overall, the new regime for pools represent an important step forward if compared to the old *status quo*. Nevertheless, doubts for the necessity of a block exemption still remain alive and kicking, and shall be considered at a later stage of this thesis.

3.2.3 *The future of agreements on Standard policy conditions*

Cooperation on the design of policy forms was generally considered acceptable as it was deemed to facilitate price comparisons for consumers.¹⁴⁹ Considering that the supply of insurance services traditionally lacks transparency, in granting a block exemption the Commission took into consideration that non-binding standard policy conditions allegedly procured efficiencies for insurance undertakings and could have benefits for consumer organisations and brokers.

¹⁴⁷ *Ibid.*, Art. 1(5) b.

¹⁴⁸ *Ibid.*, Art. 1(4)a, and Art. 1(4)b.

¹⁴⁹ See Patricia M. Danzon, *The McCarran-Ferguson Act: Anticompetitive or Procompetitive?*, above, p.28. On this point see also M. Faure, “*Insurance and competition law: balancing the conflicts*”, available at the following link: <http://www.nottingham.ac.uk/business/cris/papers/Grif%20-%20Michael%20Faure.pdf> (accessed on 3 July 2011) .

Exactly as with any kind of service industry, consumers need to have access to information in order to determine which service provider is most suitable for them. Information deficiencies are theoretically capable of deterring the functioning of the market, leading to ineffective results.¹⁵⁰ A block exemption relating to the standardisation of policy conditions was therefore considered the correct regulatory response to an “alleged market failure”.¹⁵¹

As from 24 March 2009, the scenario is radically different. The new Regulation represents a weighty rebuttal of the above approach and the end of the block exemption in this area. The Regulation does not regard standard policy conditions as a sufficiently sector-specific feature to merit special treatment by way of block exemption coverage. The Commission believes that insurance undertakings should be capable of assessing whether co-operation on standards is competition law compliant on the same basis as companies in other sectors, and guidance to this end will be issued separately in due course.

In the meantime, it needs to be emphasised that the removal of standard policy wording from the comfort zone of a block exemption is significant news and is likely to create legal uncertainty for the industry, which may soon have to assess the competition law sensitivity of each standardisation agreement.¹⁵²

The rationale for this radical change of policy appears to be that in the absence of a block exemption for standard terms, competition would allegedly be enhanced by virtue of the fact that insurers could supply a greater variety of policies.

¹⁵⁰ See M. Faure, *“Insurance and competition law: balancing the conflicts”*, above, p. 11. On this point see also Patricia M. Danzon, *“The McCarran-Ferguson Act: Anticompetitive or Procompetitive?”*, above, p.28.

¹⁵¹ See M. Faure, *“Insurance and competition law: balancing the conflicts”*, above, p. 11.

¹⁵² As recently happened in connection with the abolition of the Council Regulation (EEC) No 4056/86 OJ L 378/4, 22/12/1986, which provided a block exemption for the maritime sector, the Commission will issue guidelines in order to help insurers verify the validity of their agreements on policy conditions *vis-à-vis* Art. 101.

In the past, the *raison d'être* supporting the current block exemption for standard policy conditions had been criticised for being erroneous both in formulation and in the proposed remedy.¹⁵³ In particular, the claim that consumers are not capable of estimating the contents of insurance contracts is perhaps formulated in excessively generic terms.

It would be convenient to consider different classes of insurance. In case of mass consumer insurance, for instance, it has been correctly noted that policies containing sharply drafted exclusion clauses, the implications of which can only be assessed by a specialised lawyer, may be difficult to understand for consumers¹⁵⁴.

On the contrary, according to economic doctrine, in the field of commercial and industrial insurance, the commercial awareness of the typology of customers does not appear to require specific legal protection¹⁵⁵. Since the problem seems thus to arise mainly in relation to non-commercial buyers, it has been argued that the repeal of the block exemption should be confined to this area and the role of insurance brokers could be emphasised as a means of consumer protection.¹⁵⁶

Clearly this was not the intention of the Commission which, with Regulation 267/2010, envisaged a complete repeal of the block exemption related to standard policy conditions. As we have established, the rationale for this decision is to be

¹⁵³ On this point see M. Faure, "*Insurance and competition law: balancing the conflicts*", above, p. 15.

¹⁵⁴ *Ibid.*, at p. 12.

¹⁵⁵ *Ibid.*

¹⁵⁶ See M. Faure, "*Insurance and competition law: balancing the conflicts*", above, p. 12. A competitive supply of insurance brokers could indeed assist consumers in finding an insurance policy that fits their preferences as far as premium and policy conditions are concerned. The Commission itself recently emphasised that insurance brokers have increased their role in most Member States, and that the role of insurance brokers can be used to strengthen the bargaining position of consumers, acting as a countervailing force to the increased bargaining power of large insurers and reinsurers. See the Commission's *Business Insurance Sector Inquiry Final Report* of 25 September 2007, available at: http://ec.europa.eu/competition/sectors/financial_services/inquiries/final_report_annex.pdf (accessed on 1 July 2011).

found in the assumption that the use of standard policy conditions was not a peculiarity of the insurance industry and thus did not deserve special consideration.

Standard policy conditions are indeed of common use in trade; nevertheless, they do give rise to antitrust concerns. On a general level, problems occur whenever an association of undertakings imposes on its members an obligation to use common terms and conditions of sale and purchase. This inevitably reverts against competition as in the first place it limits the freedom of the undertakings involved to provide conditions which vary from the one imposed upon them. Most importantly, consumers may also be harmed by such practices as their choice of service providers is inevitably narrowed down.

Conversely, standard policy conditions are less likely to have a detrimental impact on competition where members retain the freedom to adopt dissimilar conditions if they wish to do so. Under the current regime, the freedom to implement diverse conditions is, as previously established, an essential condition for the exemption. Notwithstanding, standard policy conditions can still have an adverse effect on competition if a large proportion of the insurance undertakings adopt the same policy conditions. Thus, the theoretical freedom to adopt different standard policy conditions does not represent in this case a safety net as customers may be left with little or no choice in practice.

A scenario without a block exemption will also inevitably give rise to the compelling need to identify suitable ways to regulate the flow of information related to insurance policies.¹⁵⁷ The key here will be the identification and the enactment of valid forms of consumer protection. In order to protect consumers, some Member

¹⁵⁷ See R. Eisen, P. Zweifel, W. Müller, *“Unternehmerische Versicherungswirtschaft: Konsequenzen Der Deregulierung Für Wettbewerbsordnung Und Unternehmensführung”*, München, Florenz, 1993, pp. 17-18. See also M. Faure, in *“Insurance and competition law: balancing the conflicts”*, above, p. 12.

States¹⁵⁸ have already enacted a system of *ex-post* control of policy conditions through courts or relevant independent authorities. Such systems appear to suggest a valid alternative in order to shield consumers against hostile policy conditions whilst granting competition between insurance undertakings.

Apart from issues related to consumer protection, the repeal of the block exemption for standard policy conditions creates a scenario where agreements between insurance undertakings will need to be assessed on a case by case basis vis-à-vis Art.101(3). The Commission will issue specific guidelines in due course in order to lead insurers through ‘self-assessment’ procedures. On the basis of Art 101(3), individual exemptions will be granted if specific conditions apply: agreements on standard policy conditions will qualify for exemption insofar as they create efficiencies that outweigh the restriction of competition, consumers obtain a fair share of those benefits, there are no less restrictive means of achieving the efficiencies, and competition is not eliminated altogether.

In order to be consistent with art 101(3), agreements on standard policy conditions will have then to prove that some leeway is granted to the undertakings concerned in terms of the possibility to deviate from the *status quo* of the agreement providing alternative conditions. For instance, an agreement binding only on specific pre-determined terms leaving the freedom to provide diverse conditions in relation to remaining provisions will be likely to benefit from an individual exemption. Conversely, agreements which will not confer any degree of freedom to provide alternative conditions will be considered anticompetitive unless beneficial for consumers. Under such circumstances, individual exemption may be granted to

¹⁵⁸ *Inter alia*, Italy and France, where the relevant competition authorities are tasked with the duty to monitor and review insurance standard policy conditions.

standardisation agreements which effectively render particularly hermetic policy conditions accessible for consumers¹⁵⁹.

Agreements on standard policy conditions could also possibly be exempt if a linkage exists with agreements on joint calculations of risks. The reason for this is that the original idea of the Commission was to provide a block exemption only for standard policy conditions related to joint calculation of risks¹⁶⁰. This idea was ultimately abandoned, but, considering that the joint calculation of risks will still be part of the new block exemption regime, it is perhaps not unreasonable to foresee a favourable treatment of standard policy conditions linked with agreements on joint calculation of risks.

3.3 The future of Joint determination of approved safety equipment

Under the current regime, agreements between insurers on technical specifications for security equipment benefit from the block exemption.

In the course of preparations of Regulation 267/2010, the original idea of the Commission was to introduce a new condition for exemption of agreements between insurers on approved security equipment.¹⁶¹ According to a proposed draft, the condition for exemption was to be that technical specifications, rules, procedures or codes of practice adopted by national associations of insurance or reinsurance undertakings in other Member States must have been explicitly recognised as equally valid by an association or associations of insurance or reinsurance undertakings in

¹⁵⁹ After the decentralization process of the enforcement of the EC competition rules introduced by Regulation 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (OJ 2003 L 1 /1) , the Commission is no longer the only body entitled to grant individual exemption. Anti-trust national authorities and national courts are also currently involved in checking the validity of co-operation agreements *vis-à-vis* Art. 101(3) of the Treaty. The burden of proof is high and lays on the applicants.

¹⁶⁰ See the Draft Commission Regulation (EU) No 267/2010 available at :

http://ec.europa.eu/comm/competition/antitrust/others/regulation_en.pdf (accessed on 3 July 2011).

¹⁶¹ *Ibid.*

one or several Member States.¹⁶² The same rationale applied to any approval of a security device or installing and maintenance undertaking issued by an association of insurance or reinsurance undertakings in another Member State.¹⁶³

Under the current block exemption regime, security devices are exempt insofar as the technical specifications and compliance assessment procedures are “precise, technically justified and in proportion to the performance to be attained by the security device concerned”¹⁶⁴. The exemption finds application whenever the rules for the evaluation of installation undertakings and maintenance undertakings are “objective, relate to their technical competence and are applied in a non-discriminatory manner”¹⁶⁵. Such specifications and rules are required to be established and distributed with an accompanying statement that insurance undertakings are “free to accept for insurance, on whatever terms and conditions they wish, other security devices or installation and maintenance undertakings which do not comply with these technical specifications or rules”.¹⁶⁶

Just as with standard policy conditions, the new Regulation draws the finishing line for the exemption of joint determination of safety equipment. Security devices are no longer considered sufficiently sector-specific to merit special treatment and will be removed from the block exemption framework.

¹⁶² See the proposed Commission Regulation (EU) No 267/2010, *above*, Article 9 (n).

¹⁶³ *Ibid.*, Article 9 (m). Moreover, the draft Regulation did not offer any exemption to technical specifications, rules, procedures or codes of practice adopted by an association or associations of insurance or reinsurance undertakings in one or several Member States if there was equivalent technical specifications, rules, procedures or codes of practice at European level.

¹⁶⁴ See Commission Regulation (EU) No 267/2010, *above*, Article 9 (a).

¹⁶⁵ *Ibid.*, Article 9 (b).

¹⁶⁶ *Ibid.*, Article 9 (c).

4 The way forward: Repealing the EU insurance block exemption?¹⁶⁷

4.1 The way forward: Repealing the EU insurance block exemption

The current regime does not consider agreements on standard policy conditions and safety equipment worthy of a block exemption.

This significant change brings us to the next level of analysis: is there still the need for a block exemption in the insurance industry related to joint calculation of risks and pooling arrangements? What, if any, would the legitimate policy reasons be for a repeal? And what would the consequences be in case of a complete repeal of the current block exemption regime?

¹⁶⁷ This Chapter is largely based on extracts and on the considerations expressed by the author in the article Lista A. *"Stairway to Competition Heaven: What Next for Insurance Competition Regulation"*, Journal of Business Law, Issue I, January 2011, p.1-28.

4.1.1 Repealing the block exemption for joint calculations and studies of risks?

On the basis of the current block exemption regime, insurers are allowed to share information and statistics in order to jointly determine the risk premium. The line of reasoning behind the Block Exemption appears to embrace the so called “premium calculation argument”.¹⁶⁸

This claim relates to the determination of premiums by insurance companies, with the rationale being that deficiencies in the individual statistics prevent insurers from attaining an accurate rating of risks. Co-operation among undertakings would therefore seem necessary in order to ensure that income and expenses are balanced, the insolvency risk is contained and the so-called ‘moral hazard problem’ is adequately faced.¹⁶⁹

The premium calculation argument furthermore posits that co-operation between insurance undertakings in relation to risk premium calculation is vital in

¹⁶⁸ For a detailed analysis of the ‘premium calculation argument’ see M. Faure, *“Insurance and competition law: balancing the conflicts”*, above, p. 22. See also M. Faure and R. Van den Bergh, *“Restrictions of competition on insurance markets and the applicability of EC anti-trust law”*, *Kyklos*, 1995, p. 65.

¹⁶⁹ See M. Faure, *“Insurance and competition law: balancing the conflicts”*, above. For a comprehensive examination of the moral hazard problem, see Mark V. Pauly, *“The Truth about Moral Hazard and Adverse Selection”*, *Syracuse University Journal*, No. 36/2007. Available at: <http://www-cpr.maxwell.syr.edu/pbriefs/pb36.pdf> (accessed on 3 July 2011). See also Mark V. Pauly, *“The Economics of Moral Hazard: Comment”* *The American Economic Review*, Vol. 58, No. 3, Part 1 (Jun., 1968), pp. 531-537. Available at: <http://www.jstor.org/stable/1813785?origin=JSTOR-pdf> (accessed on 3 July 2011). Moral hazard is defined by economists as ‘behaviours that can lead to asymmetric information between market participants’ (see A. Sagi, E. Patiki, *“Consumer Behaviour and Asymmetric Information Theory”*, available at: <http://www.bmf.hu/> (accessed on 3 July 2011)). In insurance, moral hazard is believed to occur when ‘the expected loss from an adverse event increases as insurance coverage increases’ (Mark V. Pauly, *“The Economics of Moral Hazard: Comment”*, above, p. 533). According to Mark V. Pauly, moral hazard can be defined as ‘the effect of having an insurance and insured’s incentives to reduce expected losses’ (Mark V. Pauly, *“The Economics of Moral Hazard: Comment”*, above, p. 534). Moral hazard problems arise whenever one market participant has no responsibility for the consequence of its actions. A person covered by an insurance policy is thus less likely to take efficient care: in other words, once insured, people are more prone to take actions that result in a claim on their policy.

order to improve the conditions of the service and thus worthy of an exemption under Article 101(3) of the Treaty.

Prima facie this argument appears to be accurate. It has been correctly noted that the peculiarity of the insurance business lies, indeed, in uncertainty¹⁷⁰. In order to accurately project the exact cost of the claims and thus to be able to determine the premium, insurers need to rely upon forecasts relating to the probability of the insured event and the foreseeable extent of the loss¹⁷¹.

Such assessment entails the need to have access to meaningful statistics, with co-operation thus necessary to generate the statistical data necessary in order to enable insurers to calculate the premiums.¹⁷² Nevertheless, economic doctrine has identified at least two main idiosyncrasies in relation to the premium calculation argument.¹⁷³ *In primis*, insurers are not the only undertakings dealing with uncertainty, as uncertainty represents a normal business risk shared by any entrepreneur carrying on an economic activity and cannot justify, *per se*, the existence of cartels.¹⁷⁴

Secondly, the premium calculation argument as enshrined in the current block exemption Regulation appears to be formulated in excessively generic terms. The doctrine has distinguished between different classes of insurance: “*Zufallsrisiken*” (risk determined by coincidence) and “*Änderungsrisiken*” (risks

¹⁷⁰ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 3.

¹⁷¹ *Ibid.*

¹⁷² The need for large statistics studies is considered particularly stringent in case of relatively infrequent claims and relatively numerous risk categories. For an overview of these issues see J. Finsinger, “*European Integration of Insurance Markets. Preliminary but novel perspectives*”, Working paper Universität Lüneburg Nr 75, 1989, pp. 70-92.

¹⁷³ These considerations are based on the criticisms formulated by M. Faure in “*Insurance and competition law: balancing the conflicts*”, above, p. 23.

¹⁷⁴ On this point see also J. Finsinger and F.A. Schmidt, “*Prices, Distribution Channels and Regulatory intervention in European insurance markets*”, above, p. 12.

relating to a change of the dangerous situation itself).¹⁷⁵ Whilst the latter are of very difficult if not impossible prediction, the former can be easily determined on the basis of the law of the large numbers without the need for any joint form of co-operation.¹⁷⁶ Among this category of risks, difficulties may nevertheless arise in the determination of ‘one –off risks’, such as catastrophe risks, which are extremely difficult to determine.

The difficulties arising in relation to *Zufallsrisiken* have been considered instead to be mainly related to the incompatibility between anti-trust law and the long duration of insurance contracts used to insure them, rather than to the nature of the risks *per se*.¹⁷⁷ Whilst long term contracts are believed by the insurers as an essential form of cooperation, especially in the field of prevention, it is rather difficult to justify their exemption under Article 101(3).¹⁷⁸

Forms of joint co-operation in the field of prevention are allegedly considered worthy of exemption, as they are deemed to allow a substantive reduction of claims which would consequently lead to a reduction of premiums ultimately beneficial of consumers.¹⁷⁹ Contrary to these opinions, the Commission regards long term

¹⁷⁵ See W. Moschel, “*Kommentar zum Kartellgesetz*”, Munchen, Beck, 1981, pp 20-24 as quoted in M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 7.

¹⁷⁶ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 7.

¹⁷⁷ *Ibid.* At p. 9, M. Faure points out that in many classes of insurance access to the relevant statistical data can be easily obtained. For instance, he emphasises that elaboration of mortality data does not require co-operation since statistical analysis of life expectancies of people are widely available to the general public. He also points out that statistical data related to the frequency of illnesses and accidents are also of easy access.

¹⁷⁸ See Comments of Assuralia on the the Commission inquiry into the European business insurance sector, available at:

http://ec.europa.eu/competition/sectors/financial_services/inquiries/replies_interim_report/17_assuralia.pdf

¹⁷⁹ For a general overview of insurance co-operation in the field of prevention, see A.W. Whitney, “*Insurance and Prevention*”, available at:

<http://www.casact.org/pubs/proceed/proceed22/22264.pdf> (accessed on 3 July 2011). For instance, preventive work on a large scale is being carried on by the fire insurance companies, and to some extent by the life insurance companies. More recently, also the stock casualty insurance companies have come to the conclusion that they must attack the problem of the automobile hazard and have taken positive steps in that direction.

insurance contracts as a threat to competition as they reduce the possibility of access to the market by new insurers.¹⁸⁰

Overall, uncertainties relating to the calculation of premium risks might be overcome by other legal means than premium fixing agreements. In the current situation, when consumers in mass insurance markets buy insurance, they are charged on the basis of the risk premium calculated by the insurers through the use of significant statistics and historical data relating to the past frequency and entity of claims. These statistics tend to strike a balance between consumers having an historical record full of claims and others having no claims or small entity claims. In substance, the risk premium calculated on the basis of these statistics represents the average premium.¹⁸¹

If insurers could not rely on the current block exemption on joint calculations and studies of risks, the main question would arise in relation to the determination of the risk premium. An alternative to joint co-operation could be represented by the introduction by law of a ‘tailor made’ type of insurance policies.¹⁸²

When customers wish to shift between insurance providers, the latter could be obliged by law to provide the existing insured with a personal certificate or register showing his past record of claims. By virtue of this system, the new insurer

¹⁸⁰ See the Commission’s *Business Insurance Sector Inquiry Interim Report* of 21 January 2007, above, p.47. Here, in case of repeal of the current block exemption, the English market with its annually renewable contracts may have a competitive head start compared to markets characterised by longer term contracts, such as France, Austria or Italy. On the structure of the UK insurance industry, see Philip Hardwick and Michel Guirguis “*The UK Insurance Industry—Structure and Performance*”, in Huebner International Series on Risk, Insurance and Economic Security, Springer US, 2007. Available at <http://www.springerlink.com/> (accessed on 3 July 2011).

¹⁸¹ The personal record of claim of the actual consumer comes into play only to a limited extent, i.e. a discount in case of no claim during the past years.

¹⁸² This idea has been formulated in the doctrine by W. Moschel, in “*Kommentar zum Kartellgesetz*”, Munchen, Beck, 1981, pp 20-24 as quoted in. M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p.23.

would then be in a position to calculate the risk premium on the basis of the personal record of the new customer.¹⁸³

This system could arguably have two beneficial features: firstly, it would represent an efficient form of information-sharing between insurers allowing them to pass on information on risks that generally promote competition rather than limiting it by cartel agreements on premiums. Secondly, this system might also enhance the competition among insurers, allowing customers to change insurance providers without being obliged (as often happens today) to start at the high beginner's premium with their new insurer.

Objections may indeed arise in relation to new customers, i.e. consumers buying insurance for the very first time, and in relation to insureds with a personal record of frequent and expensive claims. The scenario theorised above would see the former unable to provide the required data to insurers, and therefore potentially subject to unduly high cost policies. The same applies to the latter, who will be penalised by the past frequency of their claims and thus may even be unable to find insurance companies prepared to offer services to them at an affordable price. For both categories of insureds fear on the part of public policy makers may arise due to the risk that a segment of consumers remain without insurance due to their inability to afford high premium costs or the refusal of undertakings to insure them.

These concerns deserve consideration and appear to cast some doubts on this alternative regulatory framework to the current regime. In response, it seems possible to claim that replacing the existing block exemption with a 'tailor made insurance system' could arguably lead to a diversification of prices and of competition

¹⁸³ See M. Faure, "*Insurance and competition law: balancing the conflicts*", above, p. 24.

beneficial also for first-time buyers and consumers with personal statistics showing a high number of past claims.

The reason is simple: if insurers are no longer able to jointly determine the risk premium, the competition among them would be mainly based on an element of price diversification by virtue of which some undertakings, particularly new market entrants, will try to attract new customers on the basis of tariffs that are very convenient for first-time buyers, whilst others will provide attractive packages for consumers with a claims intensive past.

As we established before, in absence of a block exemption for the joint determination of risks, difficulties for insurers could arise in relation to the calculation of one off risks (e.g. fire and operational failure) and no-fault based risks. Nevertheless, many statistical data, e.g. mortal car accidents rather than average life statistics are nowadays widely available and do not require the need for cooperation. These data are, in fact, also often accessible for no-fault based risks, e.g. flooding of a particular property, and may as well represent the basis for the calculation of the individual risks although they are not linked with the behaviour of the insured.¹⁸⁴

In case of liability insurance, the theorised individual system of calculation of risks might not only represent a suitable alternative to the current block exemption regime, but may also lead to the creation of market efficiencies. The doctrine has identified the creation of a linkage between the premium and the behaviour of the insured as an efficient way to face the moral hazard problem.¹⁸⁵

¹⁸⁴ Some of these statistics are available at governmental links, such as: <http://www.statistics.gov.uk/cci/nugget.asp?id=881> (accessed on 3 July 2011).

¹⁸⁵ As mentioned before, once insured, people are more willing to take actions that result in cashing in their policy. In seminal economic studies of accident law, "liability rules are seen as instruments to achieve reduction of accident costs" See S. Shavell, *"Economic analysis of accident law"*, Harvard University Press, Cambridge, 1987, p. 36.

For instance, in the case of fault based insurance, where policies are solely determined on the basis of the conduct of the individual concerned, competition is in fact deemed to ensure the creation of an optimal scenario whereby the premium perfectly reflects the behaviour of the insured, and, as a consequence, the moral hazard problem is efficiently faced.

A competitive insurance market could therefore arguably not have only a positive effect on moral hazard issues, as it is allegedly deemed to enable the narrowing of the need for risk pools. And pools, as we are about to discover in the following, are considered crucial in order to avoid the risks of moral hazard and adverse selection.¹⁸⁶

4.1.2 Repealing the Block exemption for the cooperation in form of co-insurance and reinsurance?

The need for insurers to cooperate in terms of coinsurance and re-insurance appears to be *prima facie* another essential element of business insurance, and represents the most extensive form of cooperation among competing insurers. The idea that co-operation between insurers is crucial and, to some extent, required by the modern insurance markets, has been endorsed by both the U.S. and European insurance regulatory frameworks.¹⁸⁷

Coinsurance and co-reinsurance groups (so-called ‘pools’) are risk-sharing joint ventures among insurers or reinsurers otherwise acting as independent

Faure (in “*Insurance and competition law: balancing the conflicts*”, above, p. 23) points out that liability rules could therefore act as deterrent and give incentives to insureds to avoid risks. Nevertheless, this scenario changes drastically if insurers do not bear losses because they are insured. At this point insurance undertakings should take over the deterrent function of liability rules and the only possibility for them to face the moral hazard problem would be to co-operate in the calculation of risks.

¹⁸⁶ *Ibid.*

¹⁸⁷ See R. Havens and M. Theisen, “*The application of United States and EEC Antitrust Laws to Reinsurance and Insurance Pooling Arrangements*”, The Antitrust Bulletin, 1986, 1300-1301. Currently, both the McCarran-Ferguson Act and Commission Regulation 267/2010 grant a block exemption for the cooperation of insurance undertakings in the form of co-insurance and reinsurance.

undertakings.¹⁸⁸ They are typically created in order to diversify and share exceptionally large, ultra-hazardous or uneven risks. Each undertaking participating in the pool benefits from the profits of the pool or bears its losses pro-rata, i.e., in proportion to the quota owned.

There are two main forms of pools: a) coinsurance pools, and b) reinsurance pools. The former are created by direct insurers in order to jointly cover specific types of risks (e.g. environmental, nuclear risks or terrorism). The foremost aim of the latter is instead to enable to diversify very large loss risks across national or international insurance markets.¹⁸⁹

In the modern economy, insurance undertakings are under an enormous amount of pressure to cover risks of a magnitude that often go beyond and above the financial means of an individual insurer.¹⁹⁰

If insurers are not in the position to diversify risks within their internal organisational structures, the natural tendency is then to cooperate with other undertakings in coinsurance or reinsurance pools;¹⁹¹ this tendency of insurers to cooperate has been considered, thus, as one of the several aspects which render business insurance a “naturally monopolistic” activity.¹⁹²

¹⁸⁸ See the Commission’s *Business Insurance Sector Inquiry Interim Report* of 25 January 2007, p. 26. Available at: http://ec.europa.eu/competition/sectors/financial_services/inquiries/interim_report_24012007.pdf (accessed on 3 July 2011).

¹⁸⁹ The availability of reinsurance provide insurers with increased capacity and flexibility offering them the possibility to cover risks otherwise for them impossible to cover.

¹⁹⁰ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 9. See also J. Finsinger, “*European Integration of Insurance Markets. Preliminary but novel perspectives*”, Working Paper Universitat Luneburg Nr. 75, 1989, pp 70-72.

¹⁹¹ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 10. See also OECD, Policy Roundtables “*Competition and Related Regulation Issues in the Insurance Industry*”, 1998, available at: <http://www.oecd.org/dataoecd/34/25/1920099.pdf>. (accessed on 3 July 2011).

¹⁹² Ibid., p.9. It is interesting to note that, till not long ago, in several Member States (e.g. Italy), the insurance industry was actually a State Monopoly.

Pooling arrangements for the joint coverage of ultra-hazardous risks and reinsurance are thus deemed to be beneficial for the competition in the insurance sector and even necessary in order to provide the insurance service in relation to peculiar types of risk. As a matter of fact, authors emphasised that risks which are not readily diversifiable in the long term are inevitably subject to more expensive insurance policies or to limited coverage availability for policyholders.¹⁹³

Such arrangements would then allegedly allow small insurance undertakings to enter into and be part of specialised markets. According to these theories, allowing small insurers to pool would therefore result in an enhancement of competition, as in the absence of co-operation, only very large insurance undertakings (and sometimes not even them) would be able to offer coverage for particular risky activities.¹⁹⁴

Pooling is also deemed to facilitate the purchase of reinsurance, and through reinsurance the capacity to insure is meant to increase in a sort of beneficial circle for the insurance industry which ultimately would also help to stabilise operating results.¹⁹⁵

Under the current regime, joint coverage is exempt provided the market shares of the participating insurers do not exceed a) 20% in the case of co-insurance; b) 25% in the case of co-reinsurance.¹⁹⁶ In line with the aforementioned economic

¹⁹³ See Patricia M. Danzon, *The McCarran-Ferguson Act: Anticompetitive or Procompetitive?*, above, p.24.

¹⁹⁴ See R. Havens and M. Theisen, *"The application of United States and EEC Antitrust Laws to Reinsurance and Insurance Pooling Arrangements"*, above, 1300-1301. See also J. Finsinger, *"Verbraucherschutz auf Versicherungsmärkten"*, München, Florentz, 1988, pp. 70-72.

¹⁹⁵ See R. Havens and M. Theisen, *"The application of United States and EEC Antitrust Laws to Reinsurance and Insurance Pooling Arrangements"*, above, 1300-1301. See also M. Faure, *"Insurance and competition law: balancing the conflicts"*, above, p. 10.

¹⁹⁶ See Commission Regulation No 267/2010, above, Article 7 (2). The rationale behind the differentiation of the market shares is that co-insurance mechanisms entail the obligation for the pool participants to apply uniform conditions and identical gross premiums, whereas in co-reinsurance pools the participants need to jointly fix the risk premium and the co-reinsurance premium. In other

theories, the new Regulation treats insurance pools favourably as they allow a greater number of insurers to enter the market, consequently increasing the opportunity of covering particular risks which would otherwise remain uncovered.

Despite such declarations of principle, the Commission did point out that pools may not always be justified, especially in case there is enough capacity for multiple pools to cover any given risk, and in absence of exhaustive ready-made list of risks which require joint coverage.¹⁹⁷

Thus, from an antitrust perspective, co-insurance and re-insurance groups raise a very important question: is it really possible to determine when a pool is necessary in order to cover a specific risk? In theoretical terms, the answer is yes. Assuming that insurers endeavour to achieve an optimal balance between premiums and losses, the more the risks are homogeneous and the higher the number of insured related to that risk, the lower the spread between premium and losses.¹⁹⁸

Insurers who do not cover large numbers of homogeneous risks effectively have three options in order to spread the risks: re-insure individually, join a co-insurance pool, or become part of a co-reinsurance group¹⁹⁹. The first option is the

words, price competition is set aside in the case of co-insurance, whereas co-reinsurance agreements still allow a certain margin of price competitiveness. For a definition of reinsurance see Merkin, R. “*Arnould’s Law of Marine Insurance and Average*”, Sweet & Maxell London, 2008, at p. 1562. In re-insurance, only one insurer is responsible for the entire cover of a specific risk, but part of the risk will be ceded to one or more insurers for re-insurance scope where the risk exceeds the financial capacity of the cedent insurer. Insurers may re-insure on an ad hoc basis or may institutionalise the re-insurance through co-reinsurance groups. Co-reinsurance groups usually determine the terms of the insurance including the level of risk premium.

¹⁹⁷ See the Commission’s *Business Insurance Sector Inquiry Interim Report* of 25 January 2007, above, p. 82.

¹⁹⁸ This point was formulated by Luc Gyselen, in “*EU antitrust Law in the Area of Financial Services*”, in ‘Fordham Corporate Law Institute, 23rd Annual conference on international Antitrust Law and Policy’, New York, 1996, p. 34. Available at: http://europa.eu.int/comm/competition/speeches/text/sp1997_005_en.html5. (accessed on 3 July 2011). For instance, in case of third party liability car insurance, the accuracy of the calculation of the risk premium will increase considerably in relation to the degree of homogeneity of the risk insured, e.g., utility cars driven by women up to 40 years old vis-à-vis all types of cars driven by people of all ages.

¹⁹⁹ This analysis is based on the theories elaborated by Luc Gyselen, in “*EU antitrust Law in the Area of Financial Services*”, above.

safest from an antitrust perspective as it does not entail any form of joint determination of risk premium. Consequently, joint co-insurance or re-insurance should be allowed only in extreme cases when forms of individual re-insurance are not sufficient to spread risks.

As often happens with theoretical legal arguments, the practical aspects are far more intricate. It is very difficult in practice to adopt specific criteria in order to ascertain how many homogeneous risks need to be insured before an acceptable spread is reached by insurers without the need to reinsure or to join co-insurance or re-insurance pools. It is equally arduous to determine when individual re-insurance practices represent an optimal and more efficient way to minimise risk rather than the use of pools.²⁰⁰

Regulation 267/2010 would therefore *prima facie* represent the optimal regulatory framework for co-insurance and re-insurance pools (although doubts do arise in relation to the extent of the current block exemption). The doctrine has emphasised that inefficiencies may indeed well arise under the current block exemption regime in relation to pool agreements especially in case of powerful lobbies characterising specific insurance segments.²⁰¹ Moreover, the Commission itself emphasises that the need for co-insurance and reinsurance pools depends mainly on the frequency of claims and diversifiability of risks.²⁰²

²⁰⁰ An attempt to do this was made in vain by Luc Gyselen, in the above quoted “*EU antitrust Law in the Area of Financial Services*” at p.45.,

²⁰¹ See M. Faure and R. Van den Bergh, “*Liability for nuclear accidents in Belgium from an interest group perspective*”, *International Review of Law and Economics*, 1990, 241-254. See also M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 11. M. Faure and R. Van den Bergh have identified examples of such inefficiencies in the field of nuclear insurance: as a result of the lobbying power of the Belgian nuclear insurance industry, the nuclear insurance and reinsurance pool agreements led to high premiums, a low availability of insurance capacity and low financial limits on the liability of the licensee of a nuclear power plant

²⁰² See the Commission’s *Business Insurance Sector Inquiry Interim Report* of 25 January 2007, above, p. 64.

These considerations revert the analysis to the rationale for allowing the block exemption of pools. If pooling is only justified under the belief that it leads to increased competition and creates efficiencies, the assumption would be that without pooling, only a limited number of insurers could provide coverage for certain types of risks²⁰³. Without any form of co-insurance or re-insurance practice, competition would thus be too limited.

Conversely, if despite the existence of a block exemption pooling causes a high degree of consolidation on insurance markets, the end result is obviously not efficient and doubts inevitably arise in relation to the current *status quo*.

Apart from issues relating to deficiencies and inefficiencies (which are likely to arise with or without a block exemption), the arguments pro and contra block exemption need to be carefully counterbalanced in view of the possibility to identify valid regulatory alternatives. The current EU block exemption generally allows the possibility for insurers to cooperate in order to insure or reinsure any risks; from this perspective, a blanket exemption in relation to all classes of risk may not be optimal.²⁰⁴

A valid alternative could be then to allow pooling arrangements for joint insurance and re-insurance only in relation to catastrophic, ultra-hazardous or uneven risks (e.g. nuclear, environmental, aviation risks and terrorism). In other words, the idea would be to confine the block exemption to risks which otherwise would remain uncovered due to the impossibility for single insurers to diversify them internally.

A suitable suggestion could therefore be to restrict the block exemption to the above mentioned specific types of risk and to maintain the current thresholds

²⁰³ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 10.

²⁰⁴ On this point see the observations made by M. Faure, in “*Insurance and competition law: balancing the conflicts*”, above, p. 10.

enshrined in Regulation 267/2010 as they represent a safe harbour against excessive concentration. New risks and other peculiar situations could be covered by individual exemptions, and, most of all, the need for pools could be remarkably reduced by the abolition of the block exemption for joint calculation of premiums.

As previously mentioned, in a perfectly competitive insurance market characterised by an effective linkage between insured behaviour and risk premium, the moral hazard problem could be arguably faced in an optimal way narrowing the need for risk pools. A teleological link therefore arguably exists between the joint calculation of premiums and the cooperation in form of co-insurance and reinsurance.

All this brings us to the next level and to very important questions: it is really feasible to repeal the insurance block exemption *tout court*? And in absence of a block exemption, how would the insurance market react? In order to answer these questions, it appears profitable to deduct some inputs of analysis from the US scenario, where the insurance block exemption is currently under scrutiny with a view of a complete repeal.

4.2 The US position

In the U.S., the McCarran-Ferguson Act²⁰⁵ introduced in 1945, established the primacy of the states in regulating the insurance industry²⁰⁶, in conjunction with the enactment of the insurance block exemption from the federal antitrust statutes²⁰⁷.

²⁰⁵ McCarran-Ferguson Act 15 U.S.C. §§ 1011-1015. Before the enactment of the first federal antitrust legal framework, the American fire industry increased considerably giving rise to concerns about competition (see the GAO Report on the “*legal principles Defining the Scope of the federal Antitrust Exemption for Insurance*”, available at: <http://www.gao.gov/products/B-304474> accessed on 20 July 2011), the following historical background summarises the findings of the GAO Report). At the beginning of the 19th century the insurance industry was dominated both economically and politically by fire insurance (see Kennet J. Meier, “*The Political Economy of Regulation: The Case of*

The block exemption enacted by the McCarran-Ferguson Act is confined to a) common risk premium tariffs; and b) common standard policy conditions. Under the Act, the insurance Industry is exempted from some federal antitrust statutes to the extent that it is regulated by the states. The exemption primarily relates to gathering data in concert for the purpose of ratemaking²⁰⁸. Conversely, no exemption is granted in case insurance undertakings boycott, act coercively, restrain trade, or violate the Sherman Act.

Insurance” State University of New York Press (Aug 1988), page 50). Prior to World War I, the largest part of marine insurance policies were stipulated with foreign undertakings, life insurance was a separate industry, and health insurance did not represent a significant segment of the insurance market at that time. Throughout the 19th century the fire insurance industry gave rise to a series of solvency concerns: in years when major fires occurred, many insurers were not able to honour payments or face losses (on this point see also Spencer L. Kimball and Ronald I. Boyce, “*The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in historical Perspective*”, Mich. L. Rev. 545, 547-49 (1958), at p. 56). In order to address the persistent distress of insolvency, insurance companies began to share and pool their loss experience data in order to formulate more accurate and rational insurance rates. At regulatory level, the first reactions came from the States which for the first time established administrative bodies in order to regulate the activities of the insurance industry, and the legality of state intervention was acknowledged by the Supreme Court in the case *Paul v. Virginia*⁷⁵ U.S. (8Wall.)168 (1868). The State Regulation framework enacted in the aftermath of *Paul v. Virginia* was shattered by the Supreme Court decision in the case *United States v. South-Eastern Underwriters Association* 322 U.S. 533 (1944). In this case, the Court also acknowledged that the Sherman Act did find application in relation to interstate insurance (on this point see also the GAO Report on the “*legal principles Defining the Scope of the federal Antitrust Exemption for Insurance*”, above, page 2). In response to the Supreme Court judgment in *United States v. South-Eastern Underwriters Association*, the Congress enacted the McCarran-Ferguson Act in 1945 regulating the U.S. insurance industry at federal level. The McCarran-Ferguson Act was enacted after the congress rejected a series of bills aiming to completely exempt the insurance industry from the Sherman Act (15 U.S.C. §§ 1-7), and the Clayton Act (15 U.S.C. §§ 12-27). The Sherman Act is designed to deal with cartels and monopolies. The Clayton Act was enacted almost 25 years after the Sherman Act in response to the perceived deficiencies in the latter (for a detailed historical background see the GAO Report on the “*legal principles Defining the Scope of the federal Antitrust Exemption for Insurance*” , above, page 6. The Clayton Act is designed to deal with price discrimination, exclusive dealings arrangements and corporate mergers. In particular, the Clayton Act prohibits direct and indirect price discrimination, exclusive dealings arrangements, corporate mergers, and interlocking directorates as long as these practices are capable of substantially hinder competition.

For a comprehensive overview of the legislative background of the McCarran-Ferguson Act see Charles D. Weller, “*The McCarran-Ferguson Act’s Antitrust Exemption for Insurance: Language, history and Policy*”, 1978 Duke L.J. 587, 589-98 (1978).

²⁰⁶ The purpose clause of the Act states that “*the continued regulation and taxation of the business of insurance by states are in the public’s best interest.*”

²⁰⁷ The McCarran-Ferguson Act was enacted after the congress rejected a series of bills aiming to completely exempt the insurance industry from the Sherman and Clayton Acts. For a comprehensive overview of the legislative background of the McCarran-Ferguson Act see Charles D. Weller, “*The McCarran-Ferguson Act’s Antitrust Exemption for Insurance: Language, history and Policy*”, 1978 Duke L.J. 587, 589-98 (1978).

²⁰⁸ See the McCarran-Ferguson Act, above, § 1012 (b).

Furthermore, the act does not exempt insurers from state antitrust laws, which explicitly prohibit insurers (and all businesses), from conspiring to fix prices or otherwise restrict competition.

The McCarran-Ferguson Act block exemption is subject to three conditions:

1) The challenged activity is part of the "business of insurance"²⁰⁹; 2) the challenged activity is regulated by state law²¹⁰ and 3) the challenged activity does not constitute a boycott of unrelated transactions.²¹¹ As we are about to discover, the US regulatory framework is not too dissimilar from the EU anti-trust scenario.

²⁰⁹ The first condition of the insurance block exemption introduced by the McCarran-Ferguson Act is that an activity constitutes part of the "business of insurance"(again, the following historical background summarises the findings of the GAO Report on the "*legal principles Defining the Scope of the federal Antitrust Exemption for Insurance*", above). Since the Act is silent in relation to the definition of what constitutes "business insurance", the definition of this concept was the object of a series of U.S. Supreme Court judgments.

During the period starting from the enactment of the McCarran-Ferguson Act till the late sixties, the Supreme Court defined the concept of business insurance as to encompass "*all activities engaged in by insurance companies*" (*Am. Family Life Assurance Co. of Columbus v. Planned Mktg. Assocs.*, 389 U.S., 1144-45 (E.D. Va. 1964, as quoted by the GAO Report on the "*legal principles Defining the Scope of the federal Antitrust Exemption for Insurance*", above, at p.3). This scenario changed radically in 1969, when the Court in *SEC v. National Securities Inc* (393 U.S. 453, 459-60 (1969), decided to give a very narrow interpretation of the notion of "business insurance" specifying that the exemption enacted by the McCarran-Ferguson Act found application solely in relation to the business insurance. After *SEC*, courts endeavored to detect the activities unique to the insurance industry, identifying three elements that need to be considered in order to ascertain whether a specific activity falls within the category of "business insurance". As indicated by the U. S. Supreme Court in *Union Labor Life Ins. Co. v. Pireno* (458 U.S. 119 1982), these elements are to be found firstly in practices related to the transfer of risk from the policyholder on to the insurance undertaking. Secondly, a linkage needs to exist between the practice and the policy relationship between insured and insurer. Thirdly, the practice needs to remain confined within the insurance industry (see the GAO Report on the "*legal principles Defining the Scope of the federal Antitrust Exemption for Insurance*", above). This "trend" was recently confirmed in the case *Gilchrist v. State Farm Mutual Automobile Ins. Co* (390 F.3d 1327, 11th Cir. 2004).

²¹⁰ The McCarran - Ferguson Act provides for an exemption of the insurance business from the federal antitrust laws only to the extent that such business is "regulated by State law". In *FTC v. National Casualty Co* 357 U.S. 560 (1958), the Supreme Court held that the power of the Federal Trade Commission (FTC) to regulate the insurance industry was withdrawn by the McCarran-Ferguson Act in those states where an insurance regulatory framework exists regardless of its specification or effectiveness. In other words, the McCarran-Ferguson exemption does not depend on the quality of a State's insurance regulatory framework or on its effective enforcement. This point was confirmed in *Mitgang v. Western Title Ins. Co.* 1974-2 Trade Cas. (CCH), and in *Commander Leasing Co. v. Transamerica Title Ins. Co.*, 447 F.2d 77, 84 (10th Cir. 1973) (see the GAO Report on the "*legal principles Defining the Scope of the federal Antitrust Exemption for Insurance*", above).

²¹¹ The third condition of the insurance federal block exemption under the McCarran-Ferguson Act is that the insurance activity may not constitute an agreement or act aiming to boycott, coerce or intimidate. The case law relating to this condition is almost entirely focused on the concept of boycott rather than the coercion and intimidation elements (see the GAO Report on the "legal principles

4.3 The McCarran Ferguson Act and the EU BER: two faces of the same coin?

Several structural and substantive elements currently differentiate the US antitrust regime from the EU regulatory framework, although the two systems are, as it will be readily appreciated, remarkably similar.

A fundamental structural difference between the U.S. and European insurance regulatory frameworks is that the McCarran-Ferguson Act introduced a peculiar concurrent system of insurance regulation at Federal and State level: as outlined above, the McCarran - Ferguson Act provides for an exemption of the insurance business from the federal antitrust laws only to the extent that such business is regulated by State law. The real intent of the McCarran-Ferguson Act was, as a matter of fact, to uphold the existing state insurance regulatory framework by virtue of which insurers were allowed to lay down and determine rates “under the auspices of industry-owned rating bureaus that filed the rates for the approval with the state regulatory authority”²¹².

The block exemption enacted by the McCarran-Ferguson Act aimed also at preserving the state regulatory structure adding an exemption from federal antitrust laws²¹³. This means that single States were (and still are) indeed in the position to freely regulate the insurance industry and even to repeal the block exemption within

Defining the Scope of the federal Antitrust Exemption for Insurance”, above). The question was solved by the Supreme Court in *St. Paul Fire & Marine Ins. Co. v. Barry*, in which the Court held that if the Congress in enacting the McCarran-Ferguson Act had the intention to confine the scope of the exception to boycotts of competing insurance companies or agents and to preclude the protection of policyholders, it would have made this concept explicitly (see the GAO Report on the “legal principles Defining the Scope of the federal Antitrust Exemption for Insurance”, above).

²¹² See D.T. Armentano, “Antitrust and Insurance: Should the McCarran Act be repealed?”, *Cato Journal*, Vol. 8, No. 3 (Winter 1989), p. 731.

²¹³ Spencer L. Kimball & Ronald N. Boyce, *The Adequacy of State Insurance Rate Regulation: The McCarran-Ferguson Act in Historical Perspective*, 56 Mich. L. Rev. 545 (1958).

their territory²¹⁴. Such scenario would be unthinkable in Europe where the block exemption was introduced by EU Regulations which became integral part of the legal systems of the Member States, and are destined to prevail in case of contrast with national laws.

Apart from procedural differences, the three conditions of the McCarran-Ferguson insurance exemption analysed above show also substantive differences between the U.S. and European insurance regulation. The current EU block exemption Regulation appears to be more specific than the American one. As previously mentioned, Regulation 267/2010 specifically exempts joint calculation and studies and risk pooling arrangements (co-insurance groups and co-reinsurance groups).

The insurance block exemption framework introduced by the McCarran-Ferguson appears to be, *prima facie*, far more generic and wider if compared to the EU regime: it is indeed up to the courts to specify the exact entity and the extent of the block exemption and its conditions. In particular, the McCarran-Ferguson Act does not limit the exemption to specific types of agreements: any activity part of the “business of insurance” can be exempted as long as it does not constitute a boycott of unrelated transactions. Nonetheless, the U.S. insurance regulation ended up exempting, just as Regulation 267/2010, activities of insurance undertakings relating to the joint calculations of tariff premiums, and the joint coverage of specific types of risks such as terrorism, environmental and nuclear risks. Security devices are not part of the U.S. block exemption regime, and now of the EU system either, as they have been removed from the new EU Block Exemption regulatory framework together with agreements on standard policy conditions.

²¹⁴ The only US state that repealed the insurance block exemption to date is California.

Beyond these considerations, what appears to be a noteworthy is the fact that the specifications offered by the US courts case law in relation to the application of the McCarran and Ferguson Act appear to draw a common thread between the two systems. For instance, in *American Column and Lumber*,²¹⁵ the US Supreme Court held that the behaviour of an insurance associations that provided its members with suggestions related future premium prices based on the exchange of past statistical data was incompatible with the McCarran and Ferguson Act. If the same case were to be considered under the current EU block exemption regulatory framework, the outcome would be exactly the same, as the exemption for the exchange of statistical data provided by the Block Exemption Regulation does not apply if there is any element of price fixing, i.e. if the exchange of information ultimately leads to agreeing the premium.²¹⁶

In *Ohio AFL-CIO v. Insurance Rating Board*,²¹⁷ the court found the practice of an association of insurance undertakings to impose to its members specific standard policy conditions against the US insurance exemption regime. Yet again, on the basis of the same considerations expressed above, a decision eventually adopted by the EU authorities on the basis of the same circumstances would have had, in the past, an identical outcome.²¹⁸ Apart from some atavistic discrepancies, the two block exemption systems appear thus to be definitely comparable if not very similar.

Most importantly, in parallel with the review process that is shaping up the new EU Block Exemption Regulation, the US Congress is currently in the process of repealing the insurance block exemption enacted in 1945 by the McCarran -

²¹⁵ 257 U.S. 357 (1921).

²¹⁶ See Regulation 358/2003, above, Art 3 (1).

²¹⁷ 451 F.2d 1178 (6th Cir. 1971).

²¹⁸ This is due to the fact that under Regulation 358/2003 standard policy conditions were exempt only insofar as , *inter alia*, they expressly mentioned that participating undertakings were free to offer different policy conditions to their customers (Art 5(1) b).

McCarran-Ferguson Act. The essence of the debate over the possible repeal of the McCarran - Ferguson Act is mainly related to the controversial information sharing practice among undertakings. Nevertheless, cooperative activities with respect to underwriting, reinsurance, and participation in risk pools have been also largely under scrutiny since many years and are still object of discussion²¹⁹. In the past two years, the consultation process activated by the Congress lead to the publication of several reports and opinions in favour or contra the repeal of the McCarran-Ferguson Act, in conjunction with a series of opinions and studies have been produced assessing the possible consequences of a post-exemption scenario²²⁰. Together with the investigations conducted at European level, the US governmental reports represent an invaluable source of information which will be now taken into account as we are about to face the next set of teleological questions: would a complete repeal of the insurance block exemption be favourable from an anti-trust perspective? How would the insurance market react to such scenario? What would the alternative regulatory means be in order to ensure effective competition among insurance undertakings?

4.4 Consequences of a complete repeal of the insurance Block Exemption Regulation

A scenario where insurers are no longer allowed to co-operate triggers conflicting visions in relation to possible consequences on the market. One stream of opinions is

²¹⁹ See, *inter alia*, D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, and the “*Report of the President and the Attorney General of the National Commission for the Review of antitrust Laws and Procedures*”, Washington D.C., Government Printing Office, 22 January 1979.

²²⁰ In the past two years, the consultation process activated by the Congress lead to the publication of several reports and opinions in favour or contra the repeal of the McCarran-Ferguson Act.

See, *inter alia*, the “*Report of the President and the Attorney General of the National Commission for the Review of antitrust Laws and Procedures*”, above.

deeply rooted in the general arguments pro block exemption and sees the interaction between insurers as beneficial in so far as promoting low costs and effective rivalry between companies of various sizes.²²¹ In an uncertain world as the insurance business, horizontal agreements and forms of cooperation should not be considered to be harmful for the social welfare.²²²

According to economic theories developed in the U.S., business competition in the insurance industry should be considered as a dynamic process developing under conditions of uncertainty that can include “interfirm rivalry as well as interfirm cooperation.”²²³

Allowing horizontal agreements between insurers may thus help to reduce information costs, price-adjustment costs, and business risk generally.²²⁴ If the probability of increasing price above competitive levels remains reasonably low, the existence of the increased efficiencies associated with cooperation between insurers is believed to be capable of enhancing social welfare.

The underlying rationale in defence of the current *status quo* would therefore be that competition law can be efficiently used in the form of a block exemption in

²²¹ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 743. On this point see also Franklin W. Nutter, *The Insurance Wars: The Battle Over McCarran-Ferguson – Keep It!*, THE BRIEF 10 (1989).3, p. 18. Jonathan R. Macy & Geoffrey P. Miller, *The McCarran-Ferguson Act of 1945: Reconceiving the Federal Role of Insurance Regulation*, 68 N.Y.U. L. Rev. 13 (1993). Alan M. Anderson, *Insurance and Antitrust Law: The McCarran-Ferguson Act and Beyond*, 25 WM. & MARY L. REV. 81 (1983).

²²² See Patricia M. Danzon, “*The McCarran-Ferguson Act: Anticompetitive or Procompetitive?*”, above, p.36. See also the GAO, “Ultimate Effects of McCarran-Ferguson Federal Antitrust Exemption on Insurer Activity are Unclear”, p. 3. Available at: <http://www.gao.gov/new.items/d05816r.pdf> (accessed on 1 July 2011).

²²³ See D.T. Armentano, “*The Failure of Antitrust Policy*”, Published in *The Freeman: Ideas on Liberty* - June 1994, p.7. Available at: <http://www.utdallas.edu/~plewin/TheFoundationforEconomicEducationonanti-trust.pdf>.(accessed on 1 July 2011).

²²⁴ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 740.

order to shelter the insurance industry from “the rigors of the free-market competitive process.”²²⁵

The paramount criticism contra the repeal of the current block exemption regime is thus based on the idea that a scenario without exemption would only increase short-term competition leading to a decrease in inter-firm competition, believed to be an essential element of efficient competition in the insurance sector.²²⁶ This criticism is deeply route into economics theories developed at the beginning of the eighties in the U.S. and then migrated to Europe. According to some conventional competition theories, consumer welfare results enhanced whenever intensive interfirm rivalry thrives.²²⁷ In a market characterised by easy access and within which products are homogenous and market information is readily available, price will naturally “tend to equal marginal costs and, in equilibrium , marginal costs.”²²⁸

These theories fail to acknowledge the concept of ‘confusopoly’ , i.e. the condition whereby the market force of competition is eroded by a group of undertakings providing similar products (services) which, rather than competing with one another, decide to intentionally mystify end users.

According to this paradigm, the presence of a high number of undertakings providing homogenous products should not be interpreted as a symptom of

²²⁵ See D.T. Armentano, “*The Failure of Antitrust Policy*”, Published in *The Freeman: Ideas on Liberty* - June 1994, above, p.10. See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 742.

²²⁶ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 742.

²²⁷ The economic theories exposed in this paragraph are based on the seminal work of P. Ash , “*Industrial Organization and Antitrust Policy*”. New York: John Wiley and Sons, 1983.

See also Baumol, William, and Ordover, Janusz. “Use of Antitrust to Subvert Competition.” *Journal of Law and Economics* 28 (May 1985): 247—65.

²²⁸ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 732.

inherent competitiveness as this scenario could lead to rather paradoxical consequences. This is due to the fact that the higher the number of undertakings in a market, the higher is the incentive for existing undertakings to collectively increase the prices²²⁹.

As a consequence, this theoretical framework leads to a sort of equilibrium whereby firms lay down monopolistic prices and consumers choose not to become informed. The reason for this is that if all undertakings charge the same price (or similar prices), end users would not find worthwhile to incur into search costs in order to find the best deal. By the same token, if end users are not informed, firms then would tend to determine monopoly prices as to maximise profits from those consumers who decide to use their services/buy their goods in a random way²³⁰.

This theoretical scenario can be effortlessly applied to the insurance industry, where by employing complex pricing schedules insurers are furthermore in the position to render the consumer's understanding the real value of their services as a rather difficult task. These informational asymmetries between undertakings and consumers can lead to price dispersion and ultimately curtail competition itself²³¹.

²²⁹ See P. Diamond, "A Model of Price Adjustment", 3(2) J. ECON. THEORY 156-58 (1971).

²³⁰ This is the famous 'Diamond paradox', theorised by P. Diamond in "A Model of Price Adjustment", above.

²³¹ On this point see R. Spiegler, 'Competition Over Agents with Boundedly Rational Expectations' 1(2) Theoretical Econ. 207 (2006). According to Spiegler's paradigm, "a market model in which profit-maximizing firms compete in multidimensional pricing strategies over a consumer, who is limited in his ability to grasp such complicated objects and therefore uses a sampling procedure to evaluate them. Firms respond to increased competition with an increased effort to obfuscate, rather than with more competitive pricing. As a result, consumer welfare is not enhanced and may even deteriorate". The paradigm of complexity of price structures is also theorised by Carlin, B. I. in "Strategic Retail Complexity in Financial Markets", Journal of Financial Economics, 2009: 91, 278-287. Carlin asserts that "complexity increases the market power of the firms because it prevents some consumers from becoming knowledgeable about prices in the market". According to his model, as soon as competition intensifies, "firms tend to add more complexity to their prices as a best response, rather than make their disclosures more transparent. Because this may substantially decrease consumer surplus in these markets, such practices have important welfare implications".

The doctrine of ‘confusopoly’ appears therefore to confute other economic paradigms which revolve around the idea of a market characterised by a high number of undertakings offering homogeneous products, as a perfectly competitive market.

It is worth noting, however, the specific downward pressure on insurance premiums exercised by virtue of insurers’ awareness of the tendency inherent to ‘good risks’ of eschewing insurance altogether if premiums become larger than the insured’s tolerance level. Although this tendency is well recognised as idiosyncratic to insurance, there appears to be no current research on the equilibrium between this mechanism and the doctrine of confusopoly as determinants of pricing structure and it is therefore not known which has the greater influence.

In particular, the inter-company cooperation in the insurance sector is considered beneficial in order to promote low costs and effective competition between insurance undertakings of various sizes²³². Repealing the block exemption would inevitably lead to curtail this cooperation between insurers through antitrust law, and this would result in an increment of costs and prices of insurance services. Higher costs and increased market concentration are considered the likely consequences of the repeal of the insurance antitrust exemption²³³.

The doctrine emphasises also that a complete repeal would likely have a detrimental impact on competition and “reduce the availability for some high-risk coverage as the threat of antitrust litigation would reduce participation in efficiency enhancing cooperative activities.”²³⁴

²³² See Patricia M. Danzon, *The McCarran-Ferguson Act: Anticompetitive or Procompetitive?*, REGULATION: THE CATO REVIEW OF BUSINESS & GOV’T (1992), p. 15.

²³³ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 743.

²³⁴ See Patricia M. Danzon, *The McCarran-Ferguson Act: Anticompetitive or Procompetitive?*, above, p.40. Although the considerations formulated by P.M. Danzon refer to the US scenario, they can be equally applied to the European insurance market.

Assuming that these considerations are valid, it is also true that, conversely, competition can be undermined by monopoly power. The doctrine points out that monopoly power can be attained through “internal growth, through merger with other firms, through inter-firm collusive agreements to reduce output or fix prices, through product differentiation, or through various legal restrictions and barriers to entry.”²³⁵ The outcome of the exercise of such kind of power, would be to “reduce consumer welfare (consumer surplus) and to misallocate scarce economic resources.”²³⁶ One of the foremost scope of antitrust laws would thus be to preserve competitive markets and to act as a deterrent for private monopoly power.²³⁷

When it comes to the insurance industry, part of the economic doctrine starts from the assumption that the insurance market is intended to be “workable competitive.”²³⁸ The reasons for this allegedly inherently competitiveness of the insurance industry are, according to these theories, mainly two.

In *primis*, the insurance products are believed to be relatively homogenous and product differentiation as a barrier to entry is not considered a relevant issue in the insurance market.²³⁹ Furthermore, the great variety of business opportunities in insurance, and the apparent absence of substantial economies of scale would allegedly “allow small, intermediate size, and large-scale firms to coexist and be rivalrous in the insurance market.”²⁴⁰

²³⁵ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 733.

²³⁶ *Ibid.*

²³⁷ *Ibid.*

²³⁸ See Joskow, “Cartels, Competition, and Regulation in the Property-Liability Insurance Industry.” *Bell Journal of Economics and Management Science* 4 (Autumn 1973): 375—427, at p.383..

²³⁹ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 732.

²⁴⁰ *Ibid.*

4.4.1 *More in defence of the current insurance antitrust acquis*

In light of the above considerations, the real controversy in the application of antitrust rules to the insurance industry would seem therefore not to lie with the nature of the market *per se*, considered, as we have just seen, perfectly competitive.

The debate should rather revolve around the forms of cooperation between insurers allowed by antitrust laws. Allowing extensive forms of co-operation between insurers has always been object of much debate. Till nowadays, in spite of the scepticisms toward inter-firm co-operation²⁴¹, the predominant economic theories endorsed by antitrust regulators justify such practices on the basis of the peculiar nature of the insurance business.

The peculiarity of the insurance industry would, thus, “lie in uncertainty”²⁴², and some authors have emphasised that forms of horizontal co-operation are not necessarily always harmful. In an uncertain world, such as the insurance business, Armentano points out that “it is not obvious that horizontal agreements lower social welfare; horizontal agreements may reduce information costs, price-adjustment costs, consumer search costs, inventory costs, and business risk generally.”²⁴³ Contrary to other industries where accounting costs are incurred in the present and are known at the time of contracting and price-making, Armentano maintains that in the insurance business, actual financial data related to specific policies can be known by insurers with complete accuracy only at the moment in which the policy expires²⁴⁴.

²⁴¹ *Ibid.*

²⁴² See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 6.

²⁴³ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 734. See also Baumol, William, and Ordover, Janusz. “Use of Antitrust to Subvert Competition.” *Journal of Law and Economics* 28 (May 1985): 247—65.

²⁴⁴ On this point see D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 736.

Allowing horizontal co-operation between insurers would therefore be the answer to an alleged structural failure inherent to the insurance industry²⁴⁵. Further, since individual insurers are unlikely to have the capacity of producing large statistical data necessary for an accurate anticipation of future costs, co-operation on statistical info is deemed to be an essential feature in order to enable insurers to achieve an efficient cost estimation and ratemaking paradigm.

These economic theories are unanimously endorsed by insurers all across Europe which vehemently support the retention of the *status quo*.²⁴⁶ The overall idea is that much is to be gained in terms of market efficiency by renewing the existing EU insurance block exemption regulatory framework.

In particular, the claim is that, if exposed to an effective anti-trust regime, the insurance market as a whole may have to face high legal expenses in order to establish the validity of agreements between insurers *vis-à-vis* Art. 101 TFEU. All this would ignite a domino effect which is deemed to cause delays, legal costs, and ultimately higher premiums for clients.²⁴⁷

Another recurrent belief is that as a consequence of the repeal of the current block exemption, the incentive would consequently be towards consolidation in the insurance industry through mergers, all this resulting yet again in higher costs for

²⁴⁵ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p.11.

²⁴⁶ See, *inter alia*, Replies to the public consultation on the Interim Report on Business insurance of the IUA (International Underwriting Association), available at: <http://www.iua.co.uk/AM/Template.cfm?Section=Home&CONTENTID=4185&TEMPLATE=/CM/ContentDisplay.cfm> (accessed on 3 July 2011).

See also, the reply of the Swedish Insurance Federation, available at: http://ec.europa.eu/competition/sectors/financial_services/inquiries/replies_interim_report/25_swedish_insurance.pdf (accessed on 3 July 2011).

See also the reply of the Association of British Insurers, available at: http://ec.europa.eu/competition/sectors/financial_services/inquiries/replies_interim_report/20_abi.pdf (accessed on 3 July 2011).

²⁴⁷ See the Reply to the public consultation on the Interim Report on Business insurance of the IUA, above.

insurance services.²⁴⁸ Recent research appears to endorse this claim²⁴⁹. It has been noted that in the last decade, banks and insurers have been allowed to merge on numerous occasions across Europe, leading to a scenario which already now denotes a remarkable degree of consolidation²⁵⁰, and this situation can only be exacerbated by the global financial crisis. One of the pivotal factors behind the high degree of consolidation characterising the financial services industry has been found in the way the EU Merger Regulation²⁵¹ has been applied to this sector²⁵². More specifically, it has been pointed out that the EU merger regulatory framework has been applied to the insurance sector in a more lenient fashion compared to other sectors of the economy²⁵³.

These observations need to be read in conjunction with the case law related to the application of Art. 101 to the insurance considered in the previous part of this thesis, and appear to corroborate the idea of a more indulgent application of Art. 102 to the insurance sector vis-a-vis a theoretical full application of Art. 101 in absence of a block exemption.

²⁴⁸ See D.T. Armentano, “*Antitrust and Insurance: Should the McCarran Act be repealed?*”, above, p. 742. See also the reply to the public consultation on the interim report on business insurance of the German Insurers Association, available at: http://ec.europa.eu/competition/sectors/financial_services/inquiries/replies_interim_report/21_gdv_en.pdf (accessed on 3 July 2011).

On this point, see also N.R. Page, “*Risky Business: Consumer Protection in the Insurance Industry*” 23 Harvard Journal on Legislation. 287 (1986), and Patricia M. Danzon, “*The McCarran-Ferguson Act: Anticompetitive or Procompetitive?*”, above, p.36.

²⁴⁹ See A. Lista, (2011) “*Darkness at the edge of town: redrawing the map for mergers and acquisitions in the financial services sector*”, Journal of Business Law, forthcoming.

²⁵⁰ For the insurance industry, see the European Commission, “*Business Insurance Sector Inquiry*”. Report of September 2007, p. 45. The Report is available at the following link:

For the banking sector, see the European Commission, “*Report on the retail banking sector Inquiry*”, 31/01/2007, at p.97. The Report is available at: <http://www.abanet.org>

²⁵¹ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EU Merger Regulation), which repealed Council Regulation (EEC) N 4064/89, the previous EU regulative framework of mergers and acquisitions.

²⁵² See A. Lista, (2011) “*Darkness at the edge of town: redrawing the map for mergers and acquisitions in the financial services sector*”, above, p.3.

²⁵³ *Ibid.* at p. 6.

4.5 Balancing the truth: Economic theories and further legal considerations

This stream of economic doctrine contra the repeal of the block exemption regime deserves serious consideration.

Nevertheless, in the opinion of the author, it appears to be contradicted by the current status of the European insurance market. It is submitted that the analysis of the impact of the current regulatory framework clearly demonstrates that despite benefiting from the block exemption, the continental insurance industry is already characterised by a high degree of consolidation.²⁵⁴

In the last few decades, the market has seen a remarkable rise in merger and acquisition activities, leading to a high foreign penetration of national markets but at the same time to a higher degree of consolidation of the insurance industry. Signs of

²⁵⁴ Research conducted by the EU Commission has shown that the EU insurance market is characterised by a high degree of consolidation. See the Commission's *Business Insurance Sector Inquiry Final Report* of 25 September 2007, above, p. 134. The criteria for market's antitrust assessment have been formulated by the economic doctrine. The criteria referred to in this paragraph are related to the ones specifically formulated for the insurance market by Patricia M. Danzon, in "*The McCarran-Ferguson Act: Anticompetitive or Procompetitive?*", *Regulation: The Cato Review of Business & Gov't* (1992), p. 15. Available at: <http://www.cato.org/pubs/regulation/regv15n2/v15n2-4.pdf> (accessed on 3 July 2011).

According to P. Danzon, the first criterion to take into account in assessing the extent of competition is market concentration, namely the "ease with which insurance undertakings can enter and exit from the market and the number of mergers and acquisitions characterising the insurance industry" (p.44). P. Danzon points out that generally that market patterns are very difficult to analyse due to their natural tendency to constantly fluctuate. This equally applies to the EU insurance market, a market particularly problematic to decode due to its heterogeneous composition (p.43).

Indeed, there is a strong case for viewing insurance merely as a conglomerate of national markets, at least within broadly related lines of insurance such as private individual lines and standard commercial lines.

According to P. Danzon, "a second potential indicator of competition is price dispersion; unfortunately, relevant price data for insurance is not routinely available" (p.43). It would be extremely difficult and costly indeed to collect information on rates filed by insurers in most Member States. Even if the task were undertaken, P. Danzon points out that determining the extent of the competition in the insurance market on the basis of rate disparity could be a misleading exercise. It might be thought that a wide range in prices proves a competitive market; according to P. Danzon e, it does not and wide disparities in prices are considered proof of very weak competition in the market. In a truly competitive market, prices are, in fact, believed to fall into a much "narrower range around a market-clearing price at the equilibrium point of the supply /demand curve" (p.44).

The "structural evidence on the number of actual and potential competitors and on patterns of entry and exit" (p.43) remains, thus, according to P. Danzon the main basis in order to assess the competitiveness of the EU insurance market.

consolidation are particularly evident in terms of number of current actual and potential competitors and access to the insurance market.²⁵⁵

The consolidation of the EU insurance market does not represent a good symptom of competition. As it is well known, a high degree of market concentration would inevitably result in an increment of prices.²⁵⁶

Empirical research has proven that in countries where the insurance industry is subject to a high degree of concentration and market regulation, the insurance prices are on average 17% higher than in countries where the insurance sector is characterised by deregulation and competitiveness among undertakings.²⁵⁷ These findings have been confirmed by studies carried out on behalf of the Commission, which show that in relation to specific types of insurance, premiums are remarkably lower in deregulated and competitive insurance markets, rather than in highly regulated ones.²⁵⁸

It is interesting to note that if the impact of the block exemption on the internal market appears to have exacerbated the tendency towards a higher concentrated market, whereas deregulation helped to open up the market entry of new insurers. In terms of access to the market, in fact, the situation is radically different, since the European Union's efforts to create a single insurance market have

²⁵⁵ See the Commission's *Business Insurance Sector Inquiry Interim Report* of January 2007, above, pp. 37-38. Existing studies of the economies of scale and scope of the insurance market seem to suggest that impact of this wave of merger and acquisition is likely to be modest in terms of efficiency gains, tending to benefit only very large insurers. See F.A. Katrishen and N.A. Scordis, "*Economies of scale in services; a study of multinational insurers*", *Journal of International Business*, 1998, No 29, pp 305-24. As pointed out by the Commission itself, in 1983 the number of syndicates at Lloyd's was 400, whereas currently only 60 of them trade actively. See the Commission's *Business Insurance Sector Inquiry Final Report* of 25 September 2007, above, p.38.

²⁵⁶ See M. Faure, "*Insurance and competition law: balancing the conflicts*", above, p. 22.

²⁵⁷ See J. Finsinger and F.A. Schmidt, "*Prices, Distribution Channels and Regulatory intervention in European insurance markets*", Working paper, University of Vienna, Business Economics Institute 1992. See also M. Faure, "*Insurance and competition law: balancing the conflicts*", above, p. 22.

²⁵⁸ See Price Waterhouse, "*The Costs of non Europe in financial Services*", Brussels, EC Commission, 1988. Available at: ec.europa.eu/economy_finance/publications/publication884_en.pdf (accessed on 3 July 2011).

led to an improvement in the conditions for competition. The key issue here was deregulation: prior to deregulation, competition in Europe between insurers was hindered by protracted procedures in order to obtain insurance licences and by regulated tariff systems that restrained competition in many Member States.²⁵⁹

The introduction of a ‘single licence’ now allows for much faster market entry. Deregulation at European level in this case was crucial in order to ensure competition, and it is important to emphasise that this positive integration development is completely unrelated to the current block exemption regime.²⁶⁰

Nevertheless, deregulation in the field of access to the market does not appear to have led to a general expansion in cross-border trade in insurance.²⁶¹ Is this stagnation of insurance services at national level in any way related to the block exemption system then? It is opinion of the author that this might well be the case. If deregulation was the key in order to favour the entrance of new insurers into the market, the block exemption seems on the contrary to have shut the door. Allowing insurers to cooperate and share information in order to determine the risk premium tariffs, together with the low degree of integration which currently characterises the internal market clearly contributed to consolidation in the sector.

The worrying aspect of the consolidation characterising the insurance industry across the internal market is that, although consolidation takes place mostly on a cross-border basis through acquisitions, from a consumer perspective choice does not improve as there is little if any cross-border provision of services.²⁶² This

²⁵⁹ See the Commission’s *Business Insurance Sector Inquiry Interim Report* of 25 January 2007, above, p. 36.

²⁶⁰ Deregulation and the introduction of the ‘single licence’ system are the result of the enactment of the ‘Third generation’ insurance Directives.

²⁶¹ See the Commission’s *Business Insurance Sector Inquiry Interim Report* of 25 January 2007, above, p. 36.

²⁶² *Ibid.*, at p.45. The differences between Member States relating to the applicable insurance contract law do not facilitate a diversification of choices for consumers.

scenario could be easily considered as a direct result of the block exemption regulation: with some exceptions²⁶³, the cooperation in the calculation of the average cost of risk and on statistical studies allowed by the current block exemption regulation remains, in fact, confined within the territories of Member States.²⁶⁴

4.5.1 A scenario without a block exemption

The scenario described above is emblematic. The current block exemption not only appears to have caused a higher degree of consolidation in the insurance industry, it has also failed to contribute to the integration of the sector at European level.

It appears that negative synergies arising from the block exemption system have contributed to the creation of a stagnating market in which the cooperation between undertakings remains confined largely within the territory of the Member States. The upshot of this scenario is the realisation of a form of cross -border consolidation currently characterising the internal market, which unfortunately did not result in an enhancement of cross border provision of insurance services.

Due to this stagnation, the EU insurance market appears to be in need of an impetus, and perhaps in the future the Commission should err on the side of deregulation in this particular case.

²⁶³ Cooperation does not seem to have a great importance in Member States such as Hungary, Denmark and Poland. See the Commission's *Business Insurance Sector Inquiry Interim Report* of 25 January 2007, above, p. 134.

²⁶⁴ See the Commission's *Business Insurance Sector Inquiry Interim Report* of 25 January 2007, above, p. 134.

These considerations shift the analysis onto the hypothetical effects of a complete repeal of the block exemption in terms of consumer welfare, as we need to bear in mind that one of the main function of competition law is consumer protection. On a general level, it must be emphasised that there are no studies demonstrating that insurance regulation is capable of producing more benefits than costs for consumers.²⁶⁵

On the contrary, studies conducted in the US seem to uphold the opposite conclusion. The major voice in favour of the repealing of the insurance block exemption is represented, *inter alia*, by the *Comments submitted by the Office of Attorney General of New York State in Response to the request for Public Comments on Immunities and Exemptions*²⁶⁶. The Report is the outcome of a two years investigation in the insurance sector carried out in the State of New York. The investigation disclosed serious and well substantiated evidence of ‘big-rigging’ that resulted in artificial inflation of commercial insurance rates in the absence of real competition²⁶⁷.

The Report furthermore outlines that the lack of competition in the insurance sector is far from being confined within the New York State territory, representing, on the contrary a pervasive national problem²⁶⁸.

²⁶⁵ See S.B. Pociask, J.P. Fuhr and L. F. Darby, “*Insurance Regulation: Market or Government Failure?*”, ACI, the American Consumer Institute, 20 March 2007., p. 1. Available at the following link: <http://www.theamericanconsumer.org/Failure.pdf> (accessed on 3 July 2011).

²⁶⁶ “*Comments submitted by the Office of Attorney General of New York State in Response to the request for Public Comments on Immunities and Exemptions*”, 15 July 2005. Available at the following link http://www.amc.gov/public_studies_fr28902/immunities_exemptions_pdf/Office_of_NY_AG_revdpdf (accessed on 3 July 2011).

²⁶⁷ See the “*Comments submitted by the Office of Attorney General of New York State in Response to the request for Public Comments on Immunities and Exemptions*”, above, pg. 9. Big rigging is “a *per se* violation of the Sherman Act because it is among the practices conclusively presumed to unreasonably restrain trade”. See *All Star Industries*, 962 F.2d at 469 n.8, citing *United States v. Flom*, 558 F.2d 1179, 1183 (5th Cir. 1977).

²⁶⁸ *Ibid.*, at p.10.

The Office of Attorney General of New York State points the finger against the McCarran-Ferguson exemption held to be responsible for the lack of competition in the insurance industry. In particular, the report outlines how detrimental it is for the competition to enable insurers to agree on rates for insurance, effectively eliminating competition between them²⁶⁹. The suggestion emerging from the document would be the repeal of the McCarran-Ferguson Act to the extent that it allows information sharing between insurers which should be subject to the same collective exchange of information standards that have been developed through the case law and that are applicable to other industries²⁷⁰.

Nevertheless, in the light of the “particular requirements of the insurance industry”²⁷¹, the Report advises the Congress to consider saving clauses in the legislation in order to enable insurers to participate in joint underwriting agreements and ancillary activities in a manner that does not restrain competition. Further, the Report also acknowledges the need for insurers to cooperate in the development of standards that would enhance consumer understanding of their insurance policies, such as standards for the use of plain language and simplified forms for insurance policies²⁷².

The findings of the Office of Attorney General of New York State’s Report have been endorsed by the Testimony of the Director of Insurance Consumer Federation of America before the Committee on the Judiciary of the U.S. Senate, regarding the implications of repealing the insurer’s antitrust exemption²⁷³.

²⁶⁹ *Ibid.*, at p.10.

²⁷⁰ *Ibid.*, at p.12.

²⁷¹ *Ibid.*, at p.13.

²⁷² See the “Comments submitted by the Office of Attorney General of New York State in Response to the request for Public Comments on Immunities and Exemptions”, above, pg. 13.

²⁷³ “The testimony of the Director of Insurance Consumer Federation of America before the Committee on the Judiciary of the U.S. Senate, regarding the implications of repealing the insurer’s

The Testimony of the U.S. consumer Federation asserts that allowing insurance undertakings to cooperate in order to determine the risk premium results in higher cost for the insured²⁷⁴. The Testimony also claims that repealing the McCarran-Ferguson Act would be beneficial for consumers and enhance competition in the insurance sector²⁷⁵. Nevertheless, empirical examples provided by the Testimony appear to warn that in case of repeal of the McCarran-Ferguson antitrust exemption, forms of co-operation between insurers would be easily caught by antitrust law²⁷⁶.

Furthermore, the Testimony emphasises that the collusive behaviour of insurers lead, *inter alia*, to the recent insurance crisis in the wake of hurricane Katrina, in the aftermath of which hundreds of thousands of people had their homeowners insurance policies cancelled due to prices skyrocketing²⁷⁷.

Most of all, the Testimony launches a *reprimenda* against the market inefficiencies of the insurance industry, which appear to be exacerbated by the collusion allowed by the McCarran-Ferguson's antitrust exemption leading insurers to charge inflated prices in order to cover inefficient operations²⁷⁸.

The US scenario represents an interesting platform for discussion; apart from a few atavistic discrepancies, the U.S. and European insurance markets are indeed

antitrust exemption", 20 June 2006. Available at the following link:
[http://www.consumersunion.org/pub/Antitrust%20Senate%20McCarran%20Repeal%20Testimony%2002007%20\(2\).pdf](http://www.consumersunion.org/pub/Antitrust%20Senate%20McCarran%20Repeal%20Testimony%2002007%20(2).pdf) (accessed on 3 July 2011).

²⁷⁴ *Ibid.*, at p.1.

²⁷⁵ *Ibid.*, at p.7.

²⁷⁶ *Ibid.*, at p.7.

²⁷⁷ See *The testimony of the Director of Insurance Consumer Federation of America before the Committee on the Judiciary of the U.S. Senate, regarding the implications of repealing the insurer's antitrust exemption*", above, pg. 9., Francis Achampong, *The McCarran-Ferguson Act and the Limited Insurance Antitrust Exemption: An Indefensible Aberration?*, 15 Seton Hall Legis. J. 141 (1991).

²⁷⁸ *Ibid.*, at p.11., see also Sanford M. Gage & Jonathan T. Zackey, *The Insurance Wars: The Battle Over McCarren-Ferguson – Repeal It!*, 18 THE BRIEF 11 (1989).2., and Laurence M. Hamric, Note, *The McCarran-Ferguson Act: A Time for Procompetitive Reform*, 29 Vand. L. Rev. 1308 (1976).

comparable, as are the insurance block exemption regulation systems enacted by the two Continents.²⁷⁹

In the US, the block exemption originally enacted by the McCarran-Ferguson Act is confined to common risk premium tariffs, and Common standard policy conditions. Under the Act, the insurance industry is exempted from some federal antitrust statutes to the extent that it is regulated by the states.

The exemption primarily relates to gathering data in concert for the purpose of ratemaking. Conversely, no exemption is granted in case insurance undertakings boycott, act coercively, restrain trade. The insurance block exemption framework introduced by the McCarran-Ferguson appears to be, *prima facie*, much more generic and wide compared to Regulation 260/2010: it was indeed up to the courts to specify the exact entity and the extent of the block exemption and its conditions. In particular, the McCarran-Ferguson Act does not limit the exemption to specific types of agreements: any activity part of the “business of insurance” can be exempted as long as it does not constitute a boycott of unrelated transactions.

Nevertheless, the U.S. insurance regulation ended up exempting, just as Regulation 358/2003 used to do, insurers activities relating to the joint calculations of tariff premiums, standard policy conditions for direct insurance and the joint coverage of specific types of risks such as terrorism, environmental and nuclear risks.

²⁷⁹McCarran-Ferguson Act 15 U.S.C. §§ 1011-1015. The McCarran-Ferguson Act was enacted after the congress rejected a series of bills aiming to completely exempt the insurance industry from the Sherman and Clayton Acts. For a comprehensive overview of the legislative background of the McCarran-Ferguson Act see Charles D. Weller, “*The McCarran-Ferguson Act’s Antitrust Exemption for Insurance: Language, history and Policy*”, 1978 Duke L.J. 587, 589-98 (1978).

A clear point of fracture between EU and US insurance regulation lies with the fact that the US regime is based upon state regulation. If in the EU the regulatory scenario has been , at least thus far, characterised by the presence of EU insurance regulatory framework superimposed on individual Member States, the US legislator adopted the opposite approach, exempting state-regulated insurance businesses from federal antitrust law.

As a result, in the US the insurance regulatory power lies with the individual States²⁸⁰, and this can lead to regulatory divergences as we are about to discover with the analysis of the introduction of Proposition 103 by the Californian State²⁸¹.

A very interesting point of the aforementioned Office of Attorney General of New York State's Report points out that the repeal of the antitrust exemption in the field of motor insurance operated by the California authorities through Proposition 103²⁸² radically changed the structure of the insurance market. A study conducted by the Consumer Federation of America²⁸³ concluded that since 1989 (the year of the enactment of Proposition 103) the motor insurance market in California

²⁸⁰ The reason for allocating regulatory powers to the states did not stem out of needs related to the regulation of the insurance industry, but rather from the federalist consolidated practice of devolving powers to individual states unless an activity can be qualified as "interstate commerce", (see the OECD Report: *"Competition and Related Regulatory Issues in the Insurance Industry"* , 1998, DAFNE/CLP(98) 20). See also OECD, *"Competition in Financial Markets"* (2009), available at: <http://www.oecd.org/dataoecd/45/16/43046091.pdf> ; On a different note, the absence of qualification of the insurance business as "interstate commerce", demonstrates a scarce 'cross border' provision of insurance services in the US.

²⁸¹ "Proposition 103" [Cal. Ins. Code §1861.01] (1987).

²⁸² Proposition 103 of November 8, 1988, the California Department of Insurance operated under the McBride-Grunsky Insurance Regulatory Act. Under this Act, insurance companies were not required to file rates for approval except for health and life. California was considered an "open competition" state in which competition was regulated by the marketplace.

²⁸³ See the Consumer Federation of America, *"Why Not the Best? The Most Effective Auto Insurance Regulation in the Nation"*, June 6, 2000. Available at: www.consumerfed.org. (accessed on 3 July 2011).

has produced “remarkable results for auto insurance consumers and for the insurance companies operating in the field.”²⁸⁴

In particular, the study reported that operating in an open competition system insurers were able to realise very substantial profits, above the national average, while consumers benefited from a remarkable decrease of the motor insurance prices.²⁸⁵

Despite the fact that these statistics are confined only to the State of California, they do possess noteworthy value. As we have just established in the above, the U.S. and European insurance markets are indeed comparable, as are the insurance block exemption regulation systems enacted by the two Continents.²⁸⁶

²⁸⁴ See “*The testimony of the Director of Insurance Consumer Federation of America before the Committee on the Judiciary of the U.S. Senate, regarding the implications of repealing the insurer’s antitrust exemption*”, above, p. 16. See also S.B. Pociask, J.P. Fuhr and L. F. Darby, “*Insurance Regulation: Market or Government Failure?*”, above, at p. 21.

²⁸⁵ See “*The testimony of the Director of Insurance Consumer Federation of America before the Committee on the Judiciary of the U.S. Senate, regarding the implications of repealing the insurer’s antitrust exemption*”, above, at p. 17. The Report findings are confirmed by other studies which emphasised that over the decade ending in 2004, California insurers enjoyed a return on equity for private passenger auto insurance of 11.1 percent vis-à-vis . 8.5 percent for the rest of USA . See, *inter alia*, the National Association of Insurers Commissioners (NAIC) “*Report on Profitability by Line by State 2004*”, available at the following link: <http://www.naic.org/> (accessed on 3 July 2011). The study outlines also that the average price for auto insurance drop from \$747.97 in 1989 (the year of the repeal of the block exemption in California), to \$717.98 in 1998.

²⁸⁶ McCarran-Ferguson Act 15 U.S.C. §§ 1011-1015. The McCarran-Ferguson Act was enacted after the congress rejected a series of bills aiming to completely exempt the insurance industry from the Sherman and Clayton Acts. For a comprehensive overview of the legislative background of the McCarran-Ferguson Act see Charles D. Weller, “*The McCarran-Ferguson Act’s Antitrust Exemption for Insurance: Language, history and Policy*”, 1978 Duke L.J. 587, 589-98 (1978).

The block exemption enacted by the McCarran-Ferguson Act is confined to common risk premium tariffs, and Common standard policy conditions Under the Act, the insurance Industry is exempted from some federal antitrust statutes to the extent that it is regulated by the states. The exemption primarily relates to gathering data in concert for the purpose of ratemaking. Conversely, no exemption is granted in case insurance undertakings boycott, act coercively, restrain trade. The insurance block exemption framework introduced by the McCarran-Ferguson appears to be, *prima facie*, much more generic and wide compared to Regulation 260/2010: it was indeed up to the courts to specify the exact entity and the extent of the block exemption and its conditions. In particular, the McCarran-Ferguson Act does not limit the exemption to specific types of agreements: any activity part of the “business of insurance” can be exempted as long as it does not constitute a boycott of unrelated transactions.

Nevertheless, the U.S. insurance regulation ended up exempting, just as Regulation 358/2003, insurers activities relating to the joint calculations of tariff premiums, standard policy conditions for direct insurance and the joint coverage of specific types of risks such as terrorism, environmental and nuclear risks.

4.6 In defence of the idea of free competition

Repealing the block exemption could have beneficial effects also in Europe, especially in light of the simultaneous enactment of possible alternative regulatory frameworks. In particular, the idea of the introduction of ‘tailor made’ or ‘individualised’ insurance policies might represent a valid solution for some forms of insurance (e.g. especially liability or fault based insurance) in terms of consumer welfare, competition, and the economics of moral hazard.

As previously established, the introduction of ‘tailor made’ insurance policies in conjunction with the advent of effective competition in the insurance industry would arguably act as a deterrent facing the so called ‘moral hazard’ problem in an efficient way. The creation of an effective linkage between the behaviour of the insured and the insurance policies would mean that competition law could be used as a tool for the implementation of complementing liability rules to be used in terms of deterrent function.²⁸⁷

A fully competitive insurance market accompanied by the introduction of insurance policies calculated on the basis of individual data might also arguably result in a greater variety of policies considered indispensable in order to guarantee the insurability of risks, and could also allow the possibility to limit risk pools, otherwise necessary in order to avoid the risks of moral hazard and adverse selection.²⁸⁸

The only main fundamental difference between the U.S. and European insurance regulatory frameworks is that the McCarran-Ferguson Act introduced a peculiar concurrent system of insurance regulation at Federal and State level, whereas the EU block exemption applies to all Member States.

As outlined above, the USA and EU block exemption regulations are very similar, identical in terms of aims and objectives.

²⁸⁷ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 23.

²⁸⁸ See M. Faure, “*Insurance and competition law: balancing the conflicts*”, above, p. 23. On this point see also G. Priest, “*The current insurance crisis and modern tort law*”, Yale Law Journal, 1987, pp. 1521-1590.

Finally, repealing the current block exemption and introducing a system of effective competition among insurers may arguably result in a remarkable improvement in terms of efficiency and correct functioning of the entire insurance industry.²⁸⁹ The current scenario is in fact characterised by the possibility of insurers to indulge in anticompetitive behaviours relying upon the shield offered by the block exemption. It is not a secret that rate service organisations and information sharing allow insurers to engage in price fixing practices, and to consequently limit the number of competitors within the market.

Furthermore, the existence of shared data renders superfluous for companies to monitor their own costs, and this, as economic doctrine correctly pointed out “leads to inefficiencies that would not otherwise exist.”²⁹⁰

In spite of the above considerations militating for a scenario seeing insurers fully exposed to anti-trust law, advocating a complete repeal without ancillary measures may not be an optimal solution. This is due to the situation of legal uncertainty that would characterise such a scenario, and, from this point of view, the claim of insurers that all this would translate into high legal costs deserves consideration.

A valid suggestion might be a repeal accompanied by the enactment of safe harbours protecting possible pro-competitive behaviours, such as the common coverage of certain types of risks (e.g. nuclear, environmental, aviation and terrorism), and the introduction of the system of individualised insurance policies theorised above another concern relating to a possible scenario without exemption is

²⁸⁹ See “*The testimony of the Director of Insurance Consumer Federation of America before the Committee on the Judiciary of the U.S. Senate, regarding the implications of repealing the insurer’s antitrust exemption*”, above, p. 16.

²⁹⁰ See “Comments to the Antitrust Modernization Commission regarding the McCarran-Ferguson Act”, available at: http://govinfo.library.unt.edu/amc/commission_hearings/pdf/060410-ABA_re_McCarran_Ferguson.pdf. (accessed on 3 July 2011).

relating to the determination of the insurer activities which would withstand the antitrust laws. In absence of a block exemption, there would be uncertainty in relation to the application of the antitrust rules by the courts. That is the reason why the United States Government Accountability Office suggests the introduction of “safe harbours” for certain insurance activities such as the collection of historical data²⁹¹.

In any event, just like what will happen with the repeal of the Block Exemption related to standard policy conditions and safety equipment, a further repeal of the remaining pillars of the Block Exemption would surely be accompanied by specific guidelines.

For the time being, the theoretical full application of Art. 101 to the insurance industry will now be considered in light of the recent EU Commission’s Guidelines on horizontal cooperation agreements²⁹².

In absence of a block exemption, any exchange of information between insurance undertakings would be capable of infringing Art.101 and should be carefully weighed beforehand in order to avoid severe sanctions. According to the Commission’s Guidelines, the exchange of market information may lead to restrictions of competition in particular in situations where it is liable to enable

²⁹¹ See the United States Government Accountability Office (GAO) Report on the “*Ultimate effects of McCarran-Ferguson Federal Antitrust Exemption on Insurer Activity*”, 28 July 2005, p. 3. Available at the following link: <http://www.gao.gov/htext/d05816r.html>. See also United States Government Accountability Office, *Legal Principles Defining the Scope of the Federal Antitrust Exemption for Insurance* (2005) available at <http://www.gao.gov/decisions/other/304474.htm>. (accessed on 3 July 2011).

²⁹²The Commission’s Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, 2011/C 11/01, 14/01/2011, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2011:011:0001:0072:EN:PDF>

undertakings to be aware of market strategies of their competitors²⁹³. When it comes to the insurance industry, the exchange of relevant statistical data between insurers can indeed qualify as an exchange of market strategies information, as joint statistical data are used in order to determine insurance premiums, which can be defined as the quintessential market strategy tool for insurers.

Nevertheless, the Guidelines also acknowledge that information exchange is common feature of many competitive markets and may generate various types of efficiency gains and help to solve problems of information asymmetries²⁹⁴. Moreover, the Commission also sees information exchanges as beneficial for consumers in case they reduce end users' search costs and improve their choice²⁹⁵.

In absence of a block exemption, exchange of information between insurers would need to be self assessed vis-a-vis the application of Art. 101. The starting point is that any information exchange can only be addressed under Article 101 if it establishes or is part of an agreement, a concerted practice or a decision by an association of undertakings.

Even in absence of an official agreement between insurers, the exchange of information may still be caught by Art. 101 if it amounts to a concerted practice. The Guidelines on horizontal cooperation point out that in line with the case-law of the Court of Justice of the European Union, the concept of a concerted practice refers to a form of coordination between undertakings by which, without it having reached the stage where an agreement properly so-called has been concluded, practical

²⁹³ See the Commission's Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, above, at paragraph 58.

²⁹⁴ *Ibid.*, paragraph 57.

²⁹⁵ *Ibid.*

cooperation between them is knowingly substituted for the risks of competition²⁹⁶. The concept of concerted practice is a broad concept which includes even a hypothetical scenario where only one insurance undertaking discloses statistical information to its competitor(s)²⁹⁷.

The next step of analysis for the assessment of the exchange of information between insurers is the identification of the nature of the exchange. As established above, not all the exchange of information practices are considered harmful by the Guidelines which, in particular, look favourably upon the exchange of historic data. According to the Guidelines, the exchange of historic data is unlikely to lead to a collusive outcome as it is unlikely to be indicative of the competitors' future conduct or to provide a common understanding on the market²⁹⁸.

When it comes to the insurance sector, the main question is whether joint statistics could qualify as historical data. On an abstract level, the answer to this question is affirmative; joint statistic data on the frequency of claims indeed has the character of historical information. Nevertheless, it is opinion of this author that the concept of historical data needs to be assessed in relation to the nature of a specific market. In a market like the insurance industry, the exchange of historic data regarding frequency of claims and other relevant statistics, despite the declarations of principle of the Commission Guidelines can have an impact on future behaviours of insurers and provide an understanding of the market. The reason for this is that, let us no forget, the exchange of historical data in the insurance industry lead to the

²⁹⁶ *Ibid.*, paragraph 60. For the definition of a concerted practice see, *inter alia*, Case C-8/08, *T-Mobile Netherlands*, paragraph 26; Joined Cases C-89/85 and others, *Wood Pulp*, [1993] ECR 1307, paragraph 63.

²⁹⁷ See the Commission's Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, above, at paragraph 62. See Joined Cases T-25/95 and others, *Cimenteries*, [2000] ECR II-491, paragraph 184.

²⁹⁸ See the Commission's Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, above, at paragraph 90.

determination of insurance premiums having severe market implications in terms of the conduct of insurance undertakings.

Where would all this leave insurers in case of a complete repeal of the current block exemption? The only possible way for insurers to circumvent the application of Art. 101 would be to prove that the information exchange may lead to efficiency gains within the meaning of Art. 101(3). According to the Guidelines, information about competitors' costs can enable companies to become more efficient if they benchmark their performance against the best practices in the industry and design internal incentive schemes accordingly²⁹⁹. Most importantly, the Guidelines explicitly refer to exchange of consumer data between companies in markets with asymmetric information about consumers (such as the financial services market)³⁰⁰. The Commission points out that within the financial services market, keeping track of the past behaviour of customers in terms of accidents or credit defaults provides an incentive for consumers to limit their risk exposure³⁰¹. Moreover, according to the Guidelines, information about consumers' past behaviour also makes it possible to detect which consumers carry a lower risk and should benefit from lower prices. In this context, information exchange can also reduce consumer lock-in, thereby inducing stronger competition, since the information is generally specific to a relationship and consumers would otherwise lose the benefit from that information when switching to another company³⁰².

The Guidelines appear therefore to offer a possibility for individual exemption under Art. 103. Nevertheless, it needs to be emphasised that restrictions

²⁹⁹ *Ibid.*, at paragraph 95.

³⁰⁰ See the Commission's Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, above, at paragraph 97.

³⁰¹ *Ibid.*

³⁰² *Ibid.*

that go beyond what is necessary to achieve the efficiency gains generated by an information exchange do not fulfil the conditions of Article 101(3)³⁰³. In order to fulfil the condition of indispensability, insurers will need to prove that the data's subject matter, aggregation, age, confidentiality and frequency, as well as coverage, of the exchange are of the kind that carries the lowest risks indispensable for creating the claimed efficiency gains³⁰⁴.

In case of a complete repeal of the insurance block exemption, this concept of indispensability of the exchange of information will assume a completely different role in view of the adoption or not of possible ancillary measures. If the repeal of the current regime is not to be accompanied by the introduction of alternative means of information sources for insurers about insureds (such as the introduction of consumer 'passports' containing individualised historic statistical data theorised above), then the Guidelines will represent an interesting platform for obtaining individual exemption of information exchange agreements.

Conversely, if the repeal of the current block exemption regulatory framework will be accompanied by the enactment of a 'tailor made insurance system', the element of the indispensability of the exchange of information will be an arduous burden of proof for insurers to overcome.

In any case, it deserves to be pointed out that according to the Guidelines, efficiency gains attained by indispensable restrictions must be passed on to consumers to an extent that outweighs the restrictive effects on competition caused by an information exchange³⁰⁵. This means that insurers will ultimately be subject to

³⁰³ *Ibid.* at paragraph 101.

³⁰⁴ *Ibid.*

³⁰⁵ See the Commission's Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, above, at paragraph 103.

the burden of proof that the exchange of information has a beneficial impact of end users.

Interestingly, the Guidelines indicate that the lower the market power of the parties involved in the information exchange, the more likely it is that the efficiency gains would be passed on to consumers to an extent that outweighs the restrictive effects on competition³⁰⁶. This means that for small insurers (and new market entrants) the burden of proof would be considerably lower compared to larger or well established market players.

Conclusions

The current framework of insurance regulation in Europe is on the verge of significant changes: as from March 2010, the drawing up of standard policy conditions for direct insurance and common rules for approving security devices will no longer be part of EU block exemption regulatory framework.

In the light of these significant changes, the time seems ripe enough for re-considering the application and scope of the entire European insurance regulation.

We have seen that the impact of the block exemption on the internal market translated into an EU insurance market characterised by a high degree of consolidation at cross-border level but not accompanied by an enhancement of cross-border provision of insurance services. As a result, competition among insurance undertakings appears to be restrained and insurance policies not well diversified.

Repealing the current block exemption system could thus seem, *prima facie* a natural way forward. In absence of a block exemption for the joint calculation and studies of risks, the enforcement of an ‘insurance tailor made system’ might arguably

³⁰⁶ *Ibid.*

lead to a diversification of prices and of an enhancement of competition beneficial for both insurers and insured. Furthermore, the diversification of policies would reflect the behaviour of the insured, helping to reach an optimal control of moral hazard risks narrowing the need for risk pools.

Valid alternatives seem to exist also in order to regulate the areas of co-insurance and re-insurance: the current EU block exemption generally allows insurers to cooperate in order to insure or reinsure any risks; from this perspective, a blanket exemption in relation to all classes of risk may not be the best possible solution. A valid solution might be to allow pooling arrangements for joint insurance and re-insurance only in relation to catastrophic, ultra-hazardous or uneven risks (e.g. nuclear, environmental, aviation risks and terrorism). In other words, the idea would be to confine the revised block exemption to risks which otherwise would remain uncovered due to the impossibility for single insurers to diversify them internally.

These considerations do not appear to represent a quantum leap, as the future of the current block exemption regulation of the insurance industry is more than ever under heavy shadows of doubts.

The EU regulators have already decided to take steps towards a considerable reduction of the scope of the current insurance antitrust immunity. In light of these imminent changes, a future scenario in which the insurance industry will be subject to effective competition does not seem to be too remote. The first steps of a stairway to competition heaven? Possible, even probable, although the concrete consequences remain to be seen and heaven could swirl into hell.

PART II –ART.101 AND THE BANKING SECTOR

5 The Application of EU Competition rules to the banking Industry: General Issues

5.1 Introduction

The aim of this chapter is to provide an introduction to the application of Art. 101 TFEU to the banking sector. The starting point will be the identification of the controversial issues relating to the impact of competition law on the banking industry.

The analysis will then focus on early case law seeking to explain how the application of EU antitrust law to the banking sector has developed since the outset of the Community till nowadays, with the intent to create a platform for the subsequent analysis of the current situation and recent developments.

5.2 The application of EU Competition rules to the banking Sector: general issues

Exactly in the same way as the insurance industry, at the outset of the Community also banks and credit undertakings denied the applicability of EU competition law to the banking sector.

We have to wait for the case *Zuchner v Bayerische Vereinsbank AG*³⁰⁷, in order to have confirmation of the fact that the EU competition framework fully applies to banks and credit institutions. The subject matter at issue in *Zuchner* was a money transfer taking place between Germany and Italy. The holder of a bank account in Germany, Mr. Zuchner, transferred some money to a payee in Italy and was charged by its bank (the Vereinsbank) a cross-border money transfer fee, which appeared to be in contrast with the nominal fee charged for national transactions. Mr Zuchner took his bank before a German court contesting the existence of a collusive practice among German banks having as its object the charging of uniform cross-border transfer fees in contrast with Art. 85 of the EC Treaty (now Art. 101 TFEU). The German court initiated a preliminary rulings procedure under Art. 234 EC³⁰⁸, seeking the advice of the ECJ in relation to the compatibility of the cross-border money transfer fees with the EU competition rules. Preliminarily, the Vereinsbank

³⁰⁷ Case C-172/80 *Zuchner v Bayerische Vereinsbank AG*, above.

³⁰⁸ Now Art. Article 267 of the Treaty of Lisbon.

contested this claim, arguing that EU Competition provisions did not apply to banking undertakings. It was maintained that by reason of the special nature of the services provided by banking undertakings, banking undertakings should have been considered as undertakings “entrusted with the operation of services of general economic interest within the meaning of Article 90 (2) (Now Article 86) and thus not subject, pursuant to that provision, to the EC competition rules.”³⁰⁹

Contrary to this claim, the ECJ held that the relevant provisions of the Treaty did not have the effect of exempting banks from EU the Competition provisions³¹⁰. In dismissing the Vereinsbank’s claim, the ECJ, therefore, held for the very first time that the EU antitrust framework fully applies to the banking sector.

5.3 The regulatory framework for the Banking Sector

Despite the declarations of principle of the ECJ in *Zuchner*, the application of EU competition law to the banking industry has in the past been thwarted by severe regulatory restrictions implemented nationally across Europe.³¹¹ These restrictions served a number of social and economic purposes, e.g. the specific allocation of

³⁰⁹ See Case C-172/80 *Zuchner v Bayerische Vereinsbank AG*, above, at paragraph 6 (emphasis added). Under Art. 90 (2), “undertakings entrusted with the operation of services of general economic interest or having the character of a revenue producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules of competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community”.

³¹⁰ *Ibid.*, at paragraph 8.

³¹¹ This analysis is based on Edey, Malcolm and Hviding, Ketil, *"An Assessment of Financial Reform in OECD Countries"*, OECD Economics Department, Working Papers, No. 154, 1995, available at: www.oecd.org/dataoecd/43/25/15171535.pdf. (accessed on 20 July 2011). Edey and Hviding point out that in the early 70s, the banking industry “was characterised by important restrictions on market forces which included controls on the prices or quantities of business conducted by financial institutions, restrictions on market access, and, in some cases, controls on the allocation of finance amongst alternative borrowers” (p.8).

finances to selected industries in the post-second world war period,³¹² and restraints on market access and competition were justified by way of concerns related to the financial stability.³¹³

Starting from the mid-70s, the European regulatory framework of the banking sector shifted towards a more market-oriented approach leading to a complete liberalisation of, *inter alia*, interest rate controls and of quantitative investment restrictions on financial bodies.³¹⁴

In particular, the process of harmonisation promoted at European level by the banking directives generated a significant liberalisation of cross-border access for foreign banks. The original plan of the Commission was to enact a regulatory framework aiming at promoting the free establishment and the provision of banking services across the internal market, and to establish a common set of rules for the supervision and the regulation of the financial institutions.³¹⁵

The first step of the harmonisation process of the banking sector was made through the adoption of the First Banking Directive³¹⁶ in 1977. The Directive aimed at prohibiting any type of discriminatory restrictions on the freedom of establishment and the freedom to provide services of banks and other financial institutions. On the

³¹² For instance, in Italy during the post-second world-war time finances were allocated to the car industry.

³¹³ On this point see Edey, Malcolm and Hviding, Ketil, above, at p.4. Edey and Hviding emphasise that in the early 70s “protection of small savers with limited financial knowledge was an important objective of controls on banks” and that “controls on banks were frequently used as instruments of macroeconomic management”(p.15).

³¹⁴ *Ibid.* at p.10. Edey and Hviding. Compulsory holdings of government securities acted as “a disguised form of taxation in that it allowed governments to keep security yields artificially low”. With some exceptions, these controls were largely eradicated by the early 1990s.

³¹⁵ For a detailed analysis of the evolution of the banking regulatory framework at European level, see for the early stages R, Greaves, “*EC Competition Law, Banking and Insurance Services*”, above, pp-20-36. For recent developments see “Summary of EC Banking Directives: a note by Crédit Lyonnais”, available at: http://www.competition-commission.org.uk/rep_pub/reports/1991/fulltext/294a4.2.pdf. (accessed on 20 July 2011).

³¹⁶ First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit Institutions ,O J L 322/ 30.

basis of the platform established by the First Directive, a Second Banking Directive³¹⁷ was enacted in 1989 with the aim to harmonise the national laws relating to the authorisation of financial institutions.

Another significant step towards the harmonisation of banking services across the internal market was taken through the enactment of the Directive on cross-border transfers³¹⁸. The aim of the Directive on cross-border transfers was to facilitate and to lay minimum quality standards for cross-border payments across the internal market. In 2001, the Directive on cross-border transfers was complemented by the adoption of Regulation 2560/2001 on cross-border payments in Euro³¹⁹.

On the basis of this platform of harmonisation, the ultimate aim of the Commission was the creation of a 'passport' whereby a bank authorised to operate within the territory of a Member state could establish branches all across the internal market without the need for any further authorisations.³²⁰

The process of harmonisation in the banking sector recently culminated in the adoption of the Capital Requirements Directive.³²¹ Together with Directive

³¹⁷ Directive 89/646/EEC of 15/12/1989 OJ N.386 of 30/12/1989.

³¹⁸ Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers OJ L 43/25, 14.2.1997.

³¹⁹ Regulation 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro OJ L 1/1, 4.1.2003, lays down price limitations in relation to fees charged to consumers aiming at rendering cross-border payments cost-equal to domestic payments. Regulation 2560/2001 initiated a process for the creation of a 'Single European Payments Area' (SEPA). The process, which is still ongoing, is governed by the European Parliament Council which aims at implementing the necessary infrastructures in order to improve the efficiency and the cost-effectiveness of cross border payments across the internal market.

³²⁰ In order to establish a higher degree of harmonisation, a series of Directives have been enacted along the way. Those Directives include, *inter alia*, : the 'Own Funds' Directive (89/299/EEC of 17 April 1989 OJ 1989 L 124/16), establishing common basic standards for the concept of own funds which member states must use when implementing Community legislation concerning the prudential supervision of credit institutions; and the 'Solvency Ratio' Directive (89/647/EEC of 18 December 1989 OJ 1989 L 386/14), determining minimum solvency ratios to be maintained by credit institutions.

³²¹ The Capital Requirements Directive is comprised of two directives: a) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) ,OJ 2006 L 177/01; and b) Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) OJ 2006 L 177/201.

2007/64/EC, the Capital Requirements Directive currently represent the regulatory point of reference of the banking sector. The Capital Requirements Directive was designed in order to create a more efficient and competitive payment market and in order to ensure the financial soundness of credit institutions. Its foremost aim was to bring benefits to consumers, who could ultimately be in the position to save on banking costs.³²²

5.4 The nature of the banking sector and antitrust issues

Part of economic doctrine appears to rebut the idea of the application of antitrust rules to a heavily regulated and ‘special’ system such as the banking sector.³²³ From an economic perspective, the need for banking regulation stems out of “microeconomic concerns over the ability of bank creditors (depositors) to monitor the risks originating on the lending side and from micro and macroeconomic concerns over the stability of the banking system in the case of a bank crisis.”³²⁴ In addition to official forms of regulations (statutory laws and administrative provisions), the banking sector has been subject to the influence of governments always ready to interfere whenever a collapse of bank or specific mergers and

³²² The Capital Requirements Directive implemented at European level the Base II agreement issued by the Basel Committee on Banking Supervision, and signed in 2004 by the G 10. The aim of the Basel II agreement was to create a series of international standard settings to be followed by banking regulators in respect to minimum capital requirements for banking undertakings. The agreement implemented the proposal for promoting self assessment procedures whereby banks can establish capital requirements appropriate to the risk they face.

³²³ See Edey, Malcolm and Hviding, Ketil, *"An Assessment of Financial Reform in OECD Countries"*, above.

³²⁴ See the International Competition Network, *"And increasing role for competition in the regulation of banks"*, Bonn, June 2005, p. 2. Available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc382.pdf> . (accessed on 20 July 2011) See also Edey, Malcolm and Hviding, Ketil, *"An Assessment of Financial Reform in OECD Countries"*, above, p. 6.

acquisitions gave rise to a widespread political pressure for intervention.³²⁵ Such official and informal forms of stringent control of the banking sector have been embraced as the epitome of the underlying idea of the banking industry falling outside the area of application of antitrust law.

In particular, regulatory forms of intervention such as restrictions for new entries, pricing restrictions, and line-of business restrictions were traditionally considered as graphic examples of the incompatibility between the banking sector and antitrust law.³²⁶

The current European regulatory framework implemented through a series of Directives had a severe impact on competition in the banking sector. Despite not leading to a substantive deregulation, the progressive process of harmonisation of the banking services across the internal market culminated in the adoption of instruments of prudential supervision defined by the economic doctrine more compatible and germane to a competitive system.³²⁷

Nowadays, and more than ever, the application of antitrust law to the banking sector is then raising important competition issues in view of the process of harmonisation implemented at European level aiming at assessing the level of

³²⁵ Two good examples are the intervention of the UK government rescuing Northern Rock in 2008, and the failed merger between the Dutch bank ABN Amro and the Italian bank Banca Intesa caused by the intervention of the Italian government in 2005.

³²⁶ In the past, banking regulatory frameworks in European countries saw the enactment of such provisions hardly compatible with competition rules. Due to the European process of harmonization of the banking industry, cross-border access to foreign bank has been subject to a high degree of liberalisation thanks to the Second Banking Directive (Directive 89/646/EEC OJ L 386/1, 30.12.1989). Directive 89/646/EEC set aside the requirement for banks established in one Member State to obtain authorisation from other Member States should they wish to establish a branch in their territory. Line of business restrictions have been also subject to an erosion process in the last few years. In Italy, for instance, in the last few years we have assisted at the elimination of the differentiation between savings and commercial banks and the separation between long term and short term institutions.

³²⁷ On this point see Edey, Malcolm and Hviding, Ketil, *"An Assessment of Financial Reform in OECD Countries"*, above, p. 14. In particular, the introduction of self-assessment procedures encouraged by the Basel II agreement is considered by Edey and Ketil as a milestone towards a more liberal regulatory approach and consequently a higher degree of competitiveness in the banking sector.

competitiveness in the banking industry across the internal market, also in view of considerations related to the fact that the banking sector is subject to sector specific regulation

. It is undeniable that sector specific regulation, e.g. financial supervision and barriers to entry can also have a severe impact on competition and on consolidation. If barriers to entry are set to high standards, the banking market may ultimately consist of a limited number of players. Conversely, in presence of low barriers to entry the threat of competition coming from new entrants can ignite waves of consolidation by way of mergers and acquisitions between established banking undertakings anxious to seize market power.

If we were to apply the aforementioned ‘global approach’ under EU law, the consolidated Commission practice of the concurrent application of sector-specific regulation and competition rules to conduct allegedly in breach of antitrust rules, would arguably lead to the full application of antitrust law to the banking sector. In other words, the subjection of financial institutions to a discrete regulatory regime, harmonised at the level of the EU, would not dispense them from complying with EU competition rules, and consolidation would invariably be seen as a negative indication of scarce competition.

Contrary to the EU approach, which revolves around the full application of antitrust law a to the application of antitrust law to the banking sector, a country which has recently introduced a novel approach is the US where the recent Supreme Court decision in *Credit Suisse*³²⁸ appeared to have opened the way along the opposite route.

³²⁸ *Credit Suisse v. Billing*, 551 U.S. 264 (2007).

In *Credit Suisse*, a group of investors initiated a legal action against US underwriters and institutional investors for manipulation of the after-market prices of stocks sold in initial public offerings (IPOs), in breach of federal and state antitrust rules. The case eventually reached the Supreme Court which held that the conduct occurring in highly regulated environments is implicitly immune from the application of antitrust laws if the application of those laws could potentially conflict with sector specific regulation.

Here lies the novelty point of *Credit Suisse*: the message arising from the US Supreme Court' judgment is very clear: industries subject to dynamic and sophisticated regulatory oversight such as the banking sector may be immune from the application of competition law. In the judgment, some points indeed clearly seem to echo the acknowledgment of the complexity of the application of antitrust rules to the banking sector³²⁹.

From a teleological perspective, is it then at all possible to reconcile the complexities arising from the application of competition law in the banking sector? The US answer arising from *Credit Suisse* is clearly negative, with the rationale being that a court of law is not equipped with the economic expertise necessary to assess the scenario arising from the banking sector, a sector already subject to sector regulation and extremely difficult to decode.

With respect, this line of reasoning is not very convincing. In the first place, the economic complexity of a sector should not justify, *per se*, the immunity from the application of antitrust law. Nevertheless, this observation perhaps strays out from the actual message arising from *Credit Suisse*, i.e., exemption from the application of

³²⁹ See *Credit Suisse v. Billing*, 551 U.S. 264 (2007), § 1157, 1173-1174.

competition law in the banking sector would arise only insofar as there is a conflict with the sector specific regulation.

It is opinion of the author that even in this case a statement of antitrust immunity can hardly be justified, and shadows should be cast on the sector regulation in contrast with antitrust law. The reason for this is that one of the primary aims of sector specific regulation should be, in the author's opinion, to foster competition, rather than impairing it. The fact that a conflict arises between the application of antitrust law and a sector regulatory framework should, *per se*, represent a motive for re-consideration of that specific regime.

The next level of analysis would be to re-consider *Credit Suisse* in light of the European scenario. Even providing that EU law was to embrace the US Supreme Courts' approach in *Credit Suisse*, it is opinion of this author that the situation would be, nevertheless, radically different. The reason for this is that unlike in the US, where courts of law are tasked with the duty of enforcement of competition law, EU antitrust law relies on an administrative-based system revolving around national antitrust authorities and ultimately the EU Commission. Contrary to courts of law, competition authorities do possess the necessary expertise to assess complex economic issues such as those stemming from the banking sector, "limiting the risk of erroneous or over-intrusive decisions through the parallel mis-application of sector-specific regulation and competition rules"³³⁰.

In light of these considerations, it is opinion of this author that the US Supreme Court's judgment in *Credit Suisse* should not reverberate across the Atlantic and cast doubts re the full application of Art. 101 to the banking sector.

³³⁰ See P. Athanassiou, "Competition Law and the Financial Services Sector, An Overview of Recent Developments", International In-house Counsel Journal, Vol. 1, No. 3, Spring 2008, at p. 428.

There are two main areas of application of Art. 101 of the Treaty when it comes to the banking sector: price competition issues and non-price competition behaviours.

Price competition issues are related to any agreements between bank undertakings, decisions by banking associations and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. In particular, price competition issues may arise from any kind of price agreements, recommended terms and conditions, with specific reference to payment systems, multilateral interchange fees and the so called ‘no-discrimination rules’.

Non-price competition issues are, on the contrary, related to operational agreements between bank undertakings, which, as it will be readily appreciated, although do not have direct repercussions on the price charged to the end users of the banking services raise serious competition concerns. For instance, agreements which restrict the access to payment systems by new banks do ignite serious antitrust interrogatives and deserve consideration.

The analysis will now focus on price competition issues. Non price competition matters will be considered in the following.

6 Price Competition Issues in the Banking Sector

6.1 Price competition issues in the banking industry: the early stage

Price agreements are a classic paradigm of possible anticompetitive patterns in the banking industry, as any system implemented by banks whereby common clients fees are charged is, *per se*, an infringement of Art. 101 TFEU.

It has been correctly noted, however, that it may be difficult in practice for a complainant to provide compelling evidence of such price fixing practices³³¹. The *Zuchner* case epitomises the compelling difficulties which may arise in terms of providing evidence of anticompetitive behaviours by banks. The ECJ here was asked to address the issues relating to the compatibility between the EU competition rules and the practice of German Banks to charge uniform cross-border transfer fees. In assessing this claim, the ECJ line of reasoning was confined to the analysis of a possible concerted practice within the meaning of Art. 101 of the Treaty³³².

Art. 101 of the Treaty prohibits, *inter alia*, any concerted practice capable of affecting trade between Member States and having as their object or effect the prevention, restriction or distortion of competition within the Common market³³³. A concerted practice has been defined by the ECJ as a “form of coordination between undertakings which, without having reached the stage where an agreement properly so called has been concluded, knowingly substitutes practical cooperation between them for the risks of competition.”³³⁴

According to the ECJ, the criteria of coordination and cooperation necessary for the existence of a concerted practice in no way require “the working out of an actual ‘plan’, but must be understood in the light of the concept inherent in the provisions of the Treaty relating to competition, according to which each trader must determine independently the policy which he intends to adopt on the Common market and the conditions which he intends to offer to his customers”.³³⁵ Although this requirement of independence does not deprive traders of

³³¹ See Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 5.

³³² See Case C-172/80 *Zuchner v Bayerische Vereinsbank AG*, above, at paragraph 10. Although the question referred to the ECJ was related to a possible infringement of both Articles 81 and 82 of the Treaty, only the latter Article was taken into account. This in view of the fact that the order submitting the reference considered only the existence of a concerted practice as a possible infringement of Community rules on competition and having regard to the fact that Article 102 deals only with abuse of dominant position without covering the existence of concerted practices, to which solely the provisions of article 82 apply.

³³³ See Art. 101 of the Treaty.

³³⁴ See Case C-48/69 *Imperial Chemical Industries Ltd v. Commission* [1972] ECR 619, at paragraph 16.

³³⁵ See Joined Cases C-40 and 114/73, *Suiker Unie v Commission* [1975] ECR 1663, at paragraph 32.

the right “to adapt themselves intelligently to the existing or anticipated conducts of their competitors”³³⁶, it does, nevertheless, strictly preclude any direct or indirect contract between such traders, the object or effect of which is to create conditions of competition which do not correspond to the normal conditions of the market in question, “regard being had to the nature of the products or services offered, the size and number of the undertakings and the volume of the said market.”³³⁷

The German bank in question (Vereinsbank) did not deny the existence of a uniform service charge for the transfers of specific amounts of money from one Member State to another³³⁸. Nevertheless, an attempt was made to emphasise that this similarity of conduct was not the result of an agreement or concerted practice between banks, the object or the effect of which was to produce results forbidden by Art. 101. It was, on the contrary, claimed that the justification for the imposition of communal charges had to be found in the costs incurred by banks in handling funds transfers.

According to the ECJ, the fact that the charges in question were justified on the basis of the costs involved in all transfers abroad normally by the German banks on behalf of their clients, did not exclude “the possibility that parallel conduct in that sphere may, regardless to the motive, result in coordination between banks which amounts to a concerted practice within the meaning of article 101 of the Treaty.”³³⁹

Considering that the practice covered international transactions, the scenario could have been considered capable of affecting trade between Member States within the meaning of Art. 101 only if the object or effect of the system was to “affect significantly the conditions of competition in the market in monetary transfers by banks from one

³³⁶ See Case C-172/80 *Zuchner v Bayerische Vereinsbank AG*, above, at paragraph 14.

³³⁷ *Ibid.*

³³⁸ *Ibid.*, at paragraph 16.

³³⁹ *Ibid.* at paragraph 17.

Member State to another.”³⁴⁰ That would have been the case, if “a concerted practice enabled the banks participating in it to congeal conditions in their present state thus depriving their customers of any genuine opportunity to take advantage of services on more favourable terms which would be offered to them under normal conditions of competition”.³⁴¹

It has been noted that the above statements are rather vague, failing in practice to address the Vereinsbank’s cost-justification argument.³⁴² Indeed, in order to be significant, the argument in support of the Vereinsbank’s position should have implied that all the German banks faced identical costs in handling cross-border transfers³⁴³.

Considering the lack of objective justifications for identical costs, it has been claimed that Vereinsbank’s cost-justification argument must have further implied that “all the German banks had agreed to pay foreign (creditor) banks a uniform interchange fee as compensation for any costs borne by the latter, and that without any need for concentration, they passed on this fee to their clients.”³⁴⁴ The essence of the argument must therefore have been based on the existence of a sort of “uniform interchange fee which produced a knock-on effect on the client fees and caused them to be identical”.³⁴⁵

If such assumptions are correct, the antitrust issues in *Zuchner* in reality translated into the legality of a multilateral interchange fee, rather than to the analysis of a uniform client fee. It has been correctly pointed out, however, that the ECJ does not refer in any way to the idea of a multilateral interchange fee³⁴⁶ when in its

³⁴⁰ *Ibid.*, at paragraph 19.

³⁴¹ *Ibid.*, at paragraph 20.

³⁴² See Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 6.

³⁴³ *Ibid.*, at p.6.

³⁴⁴ See Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 6.

³⁴⁵ *Ibid.*, at p. 6.

³⁴⁶ *Ibid.*, at p. 6.

judgments it mentions “a concerted practice enabling the banks participating in it to congeal conditions in their present state”³⁴⁷.

The analysis of the phenomenon of multilateral interchange fees and their repercussions on competition will be carried out in the next chapter. For now, the attention will remain on the *Zuchner* case, which provides further interesting points worthy of analysis.

6.2 The Zuchner case and the judicial assessment of price agreements

Having established the theoretical basis for the application of Art. 101 in terms of concerted practices to the banking sector, in *Zuchner* the ECJ left to national courts the task of the concrete assessment of the situation, providing, nevertheless, interesting guidelines. In order to establish whether a concerted practice among banks charging communal fees subsists, the ECJ in *Zuchner* suggests to consider specific aspects of the concrete scenario. Firstly, the Court invites national judicial bodies to consider possible links between bank undertakings, i.e., if they are exchanging information on the subject of, *inter alia*, “the rate of the charges actually imposed for comparable transfers which have been carried out or are planned for the future and whether, regard being had to the conditions of the market in question, the rate of charge uniformly imposed is no different from that which would have resulted from the free play of competition.”³⁴⁸

The first key element for the assessment of a concerted practice in the banking industry is, thus, the existence of any sort links in terms of contracts or information exchange between banking undertakings. According to the ECJ, consideration must be also given to “the number and importance in the market in monetary

³⁴⁷ See Case C-172/80 *Zuchner v Bayerische Vereinsbank AG*, above, at paragraph 20.

³⁴⁸ See Case C-172/80 *Zuchner v Bayerische Vereinsbank AG*, above, at paragraph 21.

transactions between Member States of the banks participating in such practice, and the volume of transfers on which the charge in question is imposed as compared with the total volume of transfers on which the charge in question is imposed as compared with the total volume of transfers made by the banks from one member country to another.”³⁴⁹

The additional elements of the number and the entity of the Community transactions undertaken by the banks allegedly participating in a concerted practice must also be taken into account.

Last, but not least, it is possible to claim the application of Article 101 of the Treaty only insofar as the contested concerted practice relating to money transfer fees is capable of “significantly affecting conditions of competition in the market for the services connected with such transfers”.³⁵⁰

In sum, in order to claim the existence of a concerted practice between banks in relation to uniform transfer fees it is necessary under *Zuchner* to prove in first place that there is a form of coordination between undertakings. Evidence of cooperation between banks (e.g. exchange of information) is therefore the first element which must be provided.

Secondly, it is necessary to prove that the banks involved are depriving their customers of any genuine opportunity to take advantage of services on more favourable terms which would be offered to them under normal conditions of competition.

Additional essential elements to be taken into account are the number and the entity of the Community transactions undertaken by the banks involved in the practice (the fulfilment of this requirement would also prove the element of intra-Community involvement necessary in order to claim the application of Art. 101 TFEU).

³⁴⁹ *Ibid.*, at paragraph 22.

³⁵⁰ *Ibid.*, at paragraph 22.

Finally, the contested concerted practice must be deemed to be capable of significantly affecting conditions of competition in the market for the services connected with such transfers.

6.2.1 The assessment of concerted practices: a realistic approach?

In light of the above considerations, it appears to be very difficult (if not prohibitive), in practice, to provide convincing evidence of concerted practices in the banking sector. In the first place, it is very difficult to provide evidence of information sharing or cooperative links between banks which, of course, tend to happen secretly and very discreetly.

The remaining elements are not easy to prove either. Proving that banks are depriving their customers of any genuine opportunity to take advantage of services on more favourable terms which would be offered to them under normal conditions of competition can indeed become an extremely intricate task. It would be necessary to carry out a very complex economic analysis of the market, and to theorise possible different scenarios relating to an ideal market characterised by a level competitive playing field.

It may be slightly less difficult, nevertheless by no means less demanding, to prove the remaining elements, i.e., to provide the number and the entity of the Community transactions undertaken by the banks involved in the practice, and to assess the possible impact of the practice on the market for the services connected with such transfers.

Overall, the *Zuchner* case seems to provide two conflicting messages: the statement of full application of EU competition rules to the banking sector; and the difficulty to provide evidence of accountable anti-competitive behaviours by banks.

6.3 The post-*Zuchner* scenario

After the ECJ judgment in *Zuchner*, payment systems were object of scrutiny of the first Commission decision related to the banking sector. In *Uniform Eurocheques*³⁵¹, antitrust issues arose in relation to the creation of the international Eurocheque system whereby a percentage of the amount of any cheque was paid to the payee bank from the Eurocheque issue bank.

The banking undertakings part of the Eurocheque System claimed that the system fell outside the scope of application of competition law due to the social and economic nature of the services provided. This claim was resoundingly rejected by the ECJ, which considered the Eurocheques System the outcome of a private initiative of financial institutions not entrusted in any way with the operation of a service of general economic interest adopted by the public authorities.³⁵²

Moreover, the Commission emphasised that even in the event that the Eurocheque system had been entrusted by an international authority or a group of national public authorities with the provision of an international means of payment, the application of the Community's competition rules to credit institutions could not in any way "obstruct fulfilment of that hypothetical special assignment."³⁵³

³⁵¹ Commission's Decision *Uniform Eurocheques* [1985] OJ L35/43.

³⁵² See the Commission's decision in *Uniform Eurocheques*, above, at paragraph 29. The mere approval and acknowledgment of the Eurocheque system by the competent authorities of the countries concerned was not considered enough for the application of Art. 90(2).

³⁵³ See the Commission decision in *Uniform Eurocheques*, above, at paragraph 30.

The analysis focused on the possible application of Article 85 (now Art.101) to the Eurocheque system. According to the Commission, any agreement or decision aiming to fix the price and the conditions relating to the presentation of a cheque in a foreign country from the home country of the institution which issued the cheque is by its nature capable of affecting trade between Member States³⁵⁴.

The agreements and decisions within the Eurocheque systems, which have as their object the fixing of the price of a service were moreover considered as restrictive practices explicitly falling within the general prohibition indicated in Article 85 (now Art, 101 (1)).

In particular, these practices were deemed to have as their effect “the prevention of the competition between the banks in any country and in specific in any Member State in the encaissing of uniform eurocheques drawn on banks in other countries.”³⁵⁵ Competition was also considered to be effectively prevented between issuing banks in the same Member State as to the maximum guaranteed amount.³⁵⁶

After concluding that the price agreement arising from the Eurocheque System was capable of appreciably affecting competition on the currency exchange market between Member States, the Commission considered the possible eligibility of the Eurocheque System for an exemption under Article Article 85 (3) (now Art, 101 (3)). The criteria for an exemption under Art. 101 were deemed to be fully met. In the first place, the Eurocheque System was considered as a remarkable contribution to the improvement payment facilities within the Common market.³⁵⁷

³⁵⁴ *Ibid.*, at paragraph 33.

³⁵⁵ *Ibid.*, at paragraph 33.

³⁵⁶ See the Commission’s decision in *Uniform Eurocheques*, above, at paragraph 35. The Commission emphasised that no bank could offer customers a guaranteed amount larger than that adopted by the national Eurocheque organization in agreement with the Eurocheque Assembly, which applied to all uniform eurocheques drawn in that country.

³⁵⁷ See the Commission Decision in *Uniform Eurocheques*, above, at paragraph 37. The Commission pointed out how under the Eurocheques System cheques drawn in the local currencies of several

Furthermore, the users of the Eurocheque system were deemed to have obtained a fair share of the resulting benefit³⁵⁸, and it was also noted that the restrictions imposed on the issuing and accepting credit institutions were indispensable in order to guarantee the correct functioning of the Eurocheque system³⁵⁹.

Competition was not considered completely impaired also by virtue of the fact that the *Eurocheque* agreements did not govern the relations between the drawee banks and their customers,³⁶⁰ and that the agreements and decisions concerned “did not afford the credit institutions which issue uniform eurocheques the possibility of eliminating competition in respect of a substantial part of international means of payment”.³⁶¹

On the basis of the existence of this form inter-system competition, the Commission decided to grant an exemption under Art. 85 (3) (now Art.101(3)).

It has been correctly noted that in *Eurocheque* the Commission did not clearly drawn a dividing line between cash distribution service characterising the

Member States were paid in full without deduction of any commission by the payee banks. This was considered extremely beneficial for the Community trading sector

³⁵⁸ See the Commission Decision in *Uniform Eurocheques*, above, at paragraph 38. In practice, the Commission noted that costumers by virtue of the Eurocheque system were capable of having access to all European currencies. They may draw cash from credit institutions in any foreign country they are visiting, and for such transactions they enjoy the benefit of the guarantee provided by their own bank and the benefit of a period of interest-free credit before the cheque drawn abroad is cleared.

³⁵⁹ See the Commission Decision in *Uniform Eurocheques*, above, at paragraph 39. The Commission pointed out how that “the encashment in a foreign country of cheque issued by a specific bank is a service which cannot be provided by the latter unless it has branches or correspondents in that foreign country” (paragraph 15). Consequently, by accepting cheques issued by banks situated abroad, the payee banks provide “to persons who are neither their own customers nor those of other banks in that country a service which is neither balanced nor compensated by an equivalent reciprocal service. When such a service is provided collectively by all the banks in one country to the customers of banks in other countries, it is indispensable that the terms and conditions for accepting and clearing the cheques concerned be determined in common between the issuing and the accepting institutions of the various centres involved.” (paragraph 39). Within the framework of such an agreement, the common and uniform determination of the remuneration for this service was considered by the Commission “inherent in and ancillary to the cooperation between the banks and their national clearing centres” (paragraph 39). The Commission outlines furthermore that the uniform fixing of the maximum guaranteed amount in a given country is indispensable in order to “avoid unnecessarily complicating the system and making centralised, simplified clearing virtually impossible” (paragraph 39).

³⁶⁰ *Ibid.*, at paragraph 42. The Commission noted how the extent to which commissions were passed on to the customers was left to the discretion of the drawee bank. Scope for competition therefore was maintained in the relations between each issuing institution and its customers.

³⁶¹ See the Commission’s decision in *Uniform Eurocheques*, above, at paragraph 41.

Eurocheque system (comprising three entities: two banks and the client signing a Eurocheque) and mere payment service (which involves four entities: the two banks, the client signing a Eurocheque, and the trader accepting a Eurocheque)³⁶². The latter ignites a cluster of more complex anti-trust issues and will be the subject of analysis in the following Chapter.

After *Eurocheque*, the Commission received a series of notifications of bank agreements providing uniform client fees. In *Association des Banques Belges*³⁶³ and in *Associazione Bancaria Italiana*³⁶⁴, the Belgian and Italian banks involved in a form of price fixing agreements decided not to enact them after receiving statements of objection from the Commission³⁶⁵. The same happened in *Dutch Banks*³⁶⁶.

More recently, banking agreements fixing uniform tariffs lead to two Commission decisions in *German Banks*,³⁶⁷ and *Lombard Club*.³⁶⁸ In *German Banks*, five German banks established the imposition of common charges in relation to specific currency-exchange transactions during the transitional period prior to the introduction of the euro. The introduction of a single currency meant the end of the possibility for banks to charge for the exchange of euro-zone currencies. In order to compensate for this predicted loss of revenue, the German banks in question concluded an agreement aiming at charging common tariffs for the exchange of euro-

³⁶² See Faull & Nikpay, “*The EC Law of Competition*”, above, p. 640.

³⁶³ See the Commission’s decision in *Belgische Vereniging der Banken/Association Belges des Banques* [1987] OJ 7/27, paragraphs 17-19.

³⁶⁴ See the Commission’s decision in *ABI* [1987] OJ L43/51, at paragraphs 14-15.

³⁶⁵ On this point see Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 6. See also See Faull & Nikpay, “*The EC Law of Competition*”, above, p. 639.

³⁶⁶ See the Commission’s decision in *Dutch Banks* [1989] OJ L253/1.

³⁶⁷ Commission Decision in *German Banks* [2003] OJ L15/1-34.

³⁶⁸ Commission Decision in *Austrian banks ‘Lombard Club’*, [2004] OJ L56/1.

zone banknotes during the transition period coming prior the introduction of a single European currency³⁶⁹.

The Commission decision in *German Banks* was eventually annulled by the Court of First Instance due to the failure of the Commission to provide enough evidence that an agreement on the effective level of the fees was put in place by the banks concerned³⁷⁰. The decision of the Court of First Instance appears to prove that it is sometimes extremely difficult to provide unequivocal evidence of price fixing agreements in the banking sector.

In *Lombard Club*, eight Austrian banks were fined by the Commission due to the establishment of a “far reaching and high institutionalised cartel covering every area of banking activity.”³⁷¹ The cartel was governed by a series of committees and sub-committees whose meetings were recorded in documents seized by the Commission. The *Lombard Club* case epitomises the difficulties arising from the application of Art. 101 to banking systems of member States traditionally based on intensive forms of co-operation between banking undertakings and not accustomed to a bare exposition to anti-trust rules. Before the accession to the EU, the Austrian system did not provide for competition laws aiming at prohibiting cartel agreements, and far from being uncommon, banking agreements were designed and intended as ‘useful means of avoiding uncontrolled price competition.’³⁷² The submissions of the Austrian banks to the Commission echoed the political and social routes of cartel agreements in the Austrian banking sector and the atavistic fear of the detrimental

³⁶⁹ Far from being just confined to the German territory, similar agreements were put in place by banking undertakings also in Belgium, Austria, Portugal, Ireland and the Netherlands, and eventually dropped after the issuing of several statements of objections by the Commission (see press releases IP/00/704, IP/00/784, IP/00/908, and IP/00/1358).

³⁷⁰ See joined cases T-44/02 OP, T-54/02 OP, T-56/02 OP, T-60/02 OP and T-61/02 OP, *Dresdner Bank and Others v Commission of the European Communities*, [2006] ECR II 357.

³⁷¹ See press release IP/02/844 of 11/06/2004.

³⁷² See Commission Decision in *Austrian banks ‘Lombard Club’*, above, at paragraph 367.

consequences arising from a ‘too rapid, and in particular, a poorly prepared transition to free competition’³⁷³.

6.4 Conclusion

This Chapter has provided a necessary background to the foremost issues relating to the application of the EU Competition rules to the banking sector. We have seen that, exactly as with the insurance industry, banking undertakings initially claimed the impossibility of the application of the EU antitrust rules to the banking industry.

Contrary to this claim, since the very first decisions on the impact of competition law on the banking industry the Commission unanimously with the ECJ emphasised that EU competition law finds full application to banking undertakings, although it has been established that the enforcement of anti-trust rules in this area posits some major complexities.

As it will be readily appreciated, this scenario gave (and still gives) rise to extremely controversial questions especially in relation to the application of antitrust law to card payment networks, the subject of scrutiny in the next chapter.

³⁷³ *Ibid.*, at paragraph 367.

7 Payment Card Systems and competition concerns: Multilateral Interchange Fees and No-discrimination rules³⁷⁴

7.1 Background³⁷⁵

³⁷⁴ This Chapter is structured on the basis of extracts and on the author's considerations expressed in Lista A. (2008) "Card Payment Systems and Competition Concerns: Multilateral Interchange Fees and No-Discrimination Rules, a Necessary Evil?", *Journal of Business Law*, Issue 7, September 2008, 686-719.

³⁷⁵ This Chapter is structured on the basis of extracts of the author's considerations expressed in Lista A. (2008) "*Card Payment Systems and Competition Concerns: Multilateral Interchange Fees and No-Discrimination Rules, a Necessary Evil?*", *Journal of Business Law*, Issue 7, September 2008, 686-719.

Money transmission represents the fulcrum of the entire modern economy. Everyday money flows uninterruptedly among individuals, corporations, governments in order to ensure payment transactions at any possible level. The overall procedure by virtue of which funds are transferred from one individual to another is known as payment system³⁷⁶.

During the last century we have assisted at drastic changes in terms of money transmission mechanisms. At the beginning of the 20th century almost all money transactions were operated mainly in cash or through cheques. Since Diners Club introduced the payment cards in 1950, the payment card systems have become one of the main transactions means characterising the modern market economy³⁷⁷.

Generally, there are two main types of payment cards distinguished on the basis of the nature of the card issuing entity: general purpose cards or bank cards, and proprietary or private label cards³⁷⁸. General purpose cards are subsidised by memberships associations and accepted by numerous and unrelated merchants³⁷⁹, whereas proprietary cards are generally accepted by a single retailer³⁸⁰.

³⁷⁶ For a definition of payment systems see, *inter alia*, the “*Encyclopedia of Banking Law*”, London Butterworth, 2002, pp 1-364. See also D. Cruickshank, “*Competition in UK Banking: A Report to the Chancellor of the Exchequer*”, March 2000, Chapter 2, p. 53. The document is available at: http://www.hm-treasury.gov.uk/documents/financial_services/banking/bankreview/fin_bank_reviewfinal.cfm.

Finally, see also Section 7 of the *Payment Systems (Regulation) Act* 1998 of Australia available at: <http://scaleplus.law.gov.au/html/pasteact/2/3141/0/PA000110.htm>

³⁷⁷ According to a research conducted by the Deutsche Bank, some 59.7 billion cashless payments were executed in the EU-25 in 2003. These transactions include payments by debit or credit card, credit transfers, direct debits, cheques and card-based e-money. Even though cheque payments accounted for 7.4 billion transactions or 12.5% of the total, they were not in the focus of the New Legal Framework. Card payments and credit transfers lead the statistics by volume, as each are used for about 30% of total cashless payments. See the Deutsche Bank Research “EU Monitor: Financial Market Special”, No. 27, 29 August 2005, p. 5. The Report is available at <http://www.dbresearch.com/>.pdf.

³⁷⁸ See the Controller of the Currency, Administrator of National Bank, “*Credit card Lending-Comptroller Handbook*”, 1998, p. 8. Available at: <http://www.occ.treas.gov/handbook/credit.pdf>.

See also D.W. Carlton and A.S. Frankel, “The antitrust Economics of Credit Card Networks”, *Antitrust Law Journal*, Vol. 63 (1995), at pp. 645-646.

³⁷⁹ See the Comptroller of the Currency, Administrator of National Bank, “*Credit card Lending-Comptroller Handbook*”, above, at p. 8. The largest part of banks offering general purpose cards are

A payment card transaction comprises the participation of four main entities: a cardholder, the card issuing bank, a payee (a retailer), and the merchant acquirer (the merchant bank). When a card holder makes a transaction using the card, he obtains goods or services by a merchant (retailer) who, in return, receives money from the merchant bank. The merchant bank on its part, obtains fund from card issuing bank³⁸¹.

In substance, the card payment service is a service essentially offered to two parties, i.e., the cardholder and the merchant: they can be defined as the end users of a circle comprising also the card issuing bank and the merchant bank. Such four party payment systems are enacted by large networks (e.g. Visa or MasterCard) requiring a certain degree of inter-bank cooperation and money transfer³⁸².

These systems are based in first place on the contractual relationship between card holders and card issuers, i.e. the bank whose name is on the card. Basically, by charging cardholders for card services “issuing banks can recoup the costs of services provided (e.g. transaction processing and billing) and earn a profit margin.”³⁸³ On their parts, issuers generally charge several fees to cardholders (e.g.

members of Visa or MasterCard, the two foremost credit card system networks. Visa and MasterCard enact worldwide payments through their operative banks. Banks acquire the membership in the network, and in return they are able to offer bank cards product and services. General purpose cards can be sub-categorised in three main types: a) debit cards, through which it is possible to access directly to the money deposited in the cardholder’s account; b) charge cards, requiring the cardholder to pay the card issuer in full for the transactions operated in a fixed period of time, at the end of that period; and c) credit cards, allowing the cardholder to take out a fixed time credit with the card issuer. On this point see the Comptroller of the Currency, Administrator of National Bank, “Credit card Lending-Comptroller Handbook”, above, at p. 11.

³⁸⁰ Proprietary cards are issued on the basis of an agreement between a bank and a merchant (e.g. a department store) and are accepted only by the merchant stipulating the agreement with a bank. On this point see the Comptroller of the Currency, Administrator of National Bank, “Credit card Lending-Comptroller Handbook”, above, at p. 11.

³⁸¹ For a detailed description see D. Cruickshank, “*Competition in UK Banking: A Report to the Chancellor of the Exchequer*”, above, at pp 251-252.

³⁸² See the Commission “*Report on the retail banking sector Inquiry*”, 31/01/2007, at p.97. The Report is available at; <http://www.abanet.org/antitrust/at-committees/at-fmi/pdf/recent-news/EC-Report-on-Retail-Banking.pdf>.

³⁸³ See the Commission “*Report on the retail banking sector Inquiry*”, above, at p.97.

annual fees and transactions fees). Moreover, issuers are usually able to attract customers through payment cards, offering them other services such as loans or current accounts³⁸⁴.

Overall, it has been noted that the payment card industry suffers from a “chicken and egg problem that needs to be solved”³⁸⁵. The essence of such problem lies in the fact that merchants are not inclined to accept payment cards unless a large number of consumers is willing to use them, and consumers on their part are not prepared to use payments cards if not accepted by merchants on a large scale³⁸⁶.

This scenario triggers network effects by virtue of which the more people are using payment cards, the larger is the number of merchants allowing card payments³⁸⁷.

7.2 Competition Issues

The impact of network effects on competition is vast. Establishing a network of payment card system is a long and difficult process requiring the use of considerable financial resources³⁸⁸. Once a payment card network has been established, the creation of new networks is so difficult that it becomes almost prohibitive. New networks willing to enter into the market are not, as a matter of fact, in an enviable

³⁸⁴ *Ibid.*

³⁸⁵ See D.S Edwards. “*The antitrust Economics of two sided Market*“, AEI-Brookings Joint Centre for Regulatory Studies, Related Publication 02-13, September 2002, at p. 2. Available at: <http://aei-brookings.org/admin/authorpdfs/redirect-safely.php?fname=../pdffiles/phpMt.pdf> (accessed on 20 July 2011).

³⁸⁶ On this point see Edwards D.S. “*Payment card business: Chickens and Eggs, and other Conundrums*”, 2001, Financial Times Online, available at: http://www.ftmastering.com/mmo/mm03_2htm (accessed on 20 July 2011).

³⁸⁷ On this point see J. McAndrews, “*Network Issues and Payment Systems*”, Philadelphia Fed’s Business Review, 1997, November-December Issue.

³⁸⁸ The most difficult step in establishing a card payments network is to increase the number of customers willing to use payment cards.

position: they would need in first place to invite customers to use their networks rather than existing ones (a very difficult task considering the tendency of customers to prefer larger networks). The second obstacle to overcome is represented by the fact that merchants are already in possession of equipment belonging to the existing network³⁸⁹.

Another remarkable impact of network effects on competition is related to the essential need for cooperation between the different parties involved in a payment card system. It is in fact vital that all four parties involved in the network (cardholder, merchant, card issuer bank and merchant bank) cooperate in order to process any payment transaction³⁹⁰.

Organisations like Visa and MasterCard have been particularly efficient in creating platforms by virtue of which their members could sign up customers and merchants in their business areas. All this ignited a sort of domino network effect ultimately leading to the creation of global brands³⁹¹.

Competition in the payment cards sector tends, thus, to be very extremely stern. Creating a new card payment network capable of competing with Visa or MasterCard appears to be a journey of titanic dimensions. Besides the obstacles created by the above mentioned network effect, competition in the payment cards sector takes place at two different levels interconnected with one another. In first place we have the so called ‘inter-system-network’ market, within which diverse

³⁸⁹ On this point see D. Cruickshank, above, at p. 65.

³⁹⁰ In order for a payment card network to function, consumers must use payment cards, which must be accepted by merchants and by both the acquiring and issuing banks. On this point see S. Sienkiewicz, “*Credit Cards and Payment Efficiency*”, Federal Reserve Bank of Philadelphia, August 2001, at p. 6. Available at: http://www.philadelphiafed.org/pcc/papers/2001/PaymentEfficiency_092001.pdf. (accessed on 20 July 2011).

³⁹¹ See S. Sienkiewicz, “*Credit Cards and Payment Efficiency*”, above, at p. 8.

payment systems networks (e.g. competition between different payment systems, namely cash payments, credit cards and cash cards) operate³⁹².

Secondly, competition takes place in the so called ‘intra-system’, where financial institutions (largely banks) compete with one another in order to issue cards to customers and acquire payments from merchants³⁹³.

Network effects, competition taking place at different levels, thus, render this area particularly complex from an antitrust perspective.

7.3 Antitrust assessment of Payment Card Systems

Traditionally, the core idea of competition lies in the rivalry between firms and their possibility to compete with one another. It has been noted above that the *sui generis* structure of the payment card networks renders competition particularly difficult in this area.

In addition to this, some authors pointed out that the nature itself of the payment card industry entails the need for cooperation as a “necessary and desirable instrument to achieve efficiencies”³⁹⁴. From this perspective, it has been further noted that the imposition of a competitive market structure is likely to have

³⁹² See the Commission’s “Guidelines on Market Investigation References”, September 2002, at p. 19. Available at: http://www.competitioncommission.org.uk/our_role/consultations/past/pdf/ebmarket.pdf. (accessed on 20 July 2011).

³⁹³ *Ibid.*, at p 19.

³⁹⁴ See, *inter alia*, D.W. Carlton, “The Economics of Cooperation and Competition in Electronics Services Network Industries”, p. 32. Available at: <http://www.nextera.com/content/publications.htm>

counterproductive effects³⁹⁵ as the “implication of network effects is that antitrust interventions may be futile”³⁹⁶.

In economic terms, the *raison d'être* for this would be that in network industries (such as the payment card industry), the markets are characterised as a ‘winner takes most’ kind of environment³⁹⁷. According to these theories, superimposing a different market structure (imposing, for instance, by law a certain degree of competition) would alter the natural equilibrium in these markets, becoming a futile and counterproductive exercise³⁹⁸.

The question to be unravelled now is how EU competition law applies to payment card systems (the question on how competition law should apply to the payment card sector will be discussed in the following).

Major payment card systems such as Visa or MasterCard are structured as organisations comprising a high number of members coordinated with one another through a network of rules or bylaws granting a high level of interoperability (e.g. multilateral interchange fees and no-discrimination rules)³⁹⁹. Such rules or bylaws can indeed be regarded as agreements between undertakings or decisions of associations of undertakings within the meaning of Art. 101 of the Treaty.

³⁹⁵ See Nicholas Economides, “*Competition Policy in Network Industries: An Introduction*”, NYU Centre for Law & Business, Working Paper Series CLB-03-021 at p. 15. Available at the following link: <http://w4.stern.nyu.edu/emplib/03-021.pdf>. (accessed on 20 July 2011).

³⁹⁶ *Ibid.*, at p. 15.

³⁹⁷ *Ibid.*, at p. 15

³⁹⁸ *Ibid.*, at p. 15

³⁹⁹ See Teresa Rodríguez de las Heras Ballell, “*Multilateral Agreements on Prices in Payments Systems: An Antitrust Approach*”, in Jose Rivas (ed), *World Competition*, Kluwer Law International 2002, Volume 25 Issue 2), pp. 223-237, at p. 224.

As a result, they can be caught by EU competition law as long as they are capable of affecting trade between Member States, or have as their object or effect the prevention, restriction or distortion of competition within the common market⁴⁰⁰.

Nevertheless, exemption can be granted in case concerted practices, agreements between undertakings or decisions of associations of undertakings which contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which do not: (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question⁴⁰¹.

The question of the application of the EU competition rules to the payment card systems mainly revolves around the nature of the rules or bylaws granting interoperability within a payment card network. What is the real impact of such intra-network rules? Are they inherently intrinsic to the operation of card payment systems? Most importantly, do they allow consumers a fair share of their alleged resulting benefit, without imposing on the undertakings concerned restrictions which are not indispensable to the attainment of their objectives?

⁴⁰⁰ See Article 101 TFEU. As noted above (See Chapter 2), Article 101 prohibits those concerted practices, agreements between undertakings or decisions of associations of undertakings which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources of supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

⁴⁰¹ See Article 101 (3) TFEU.

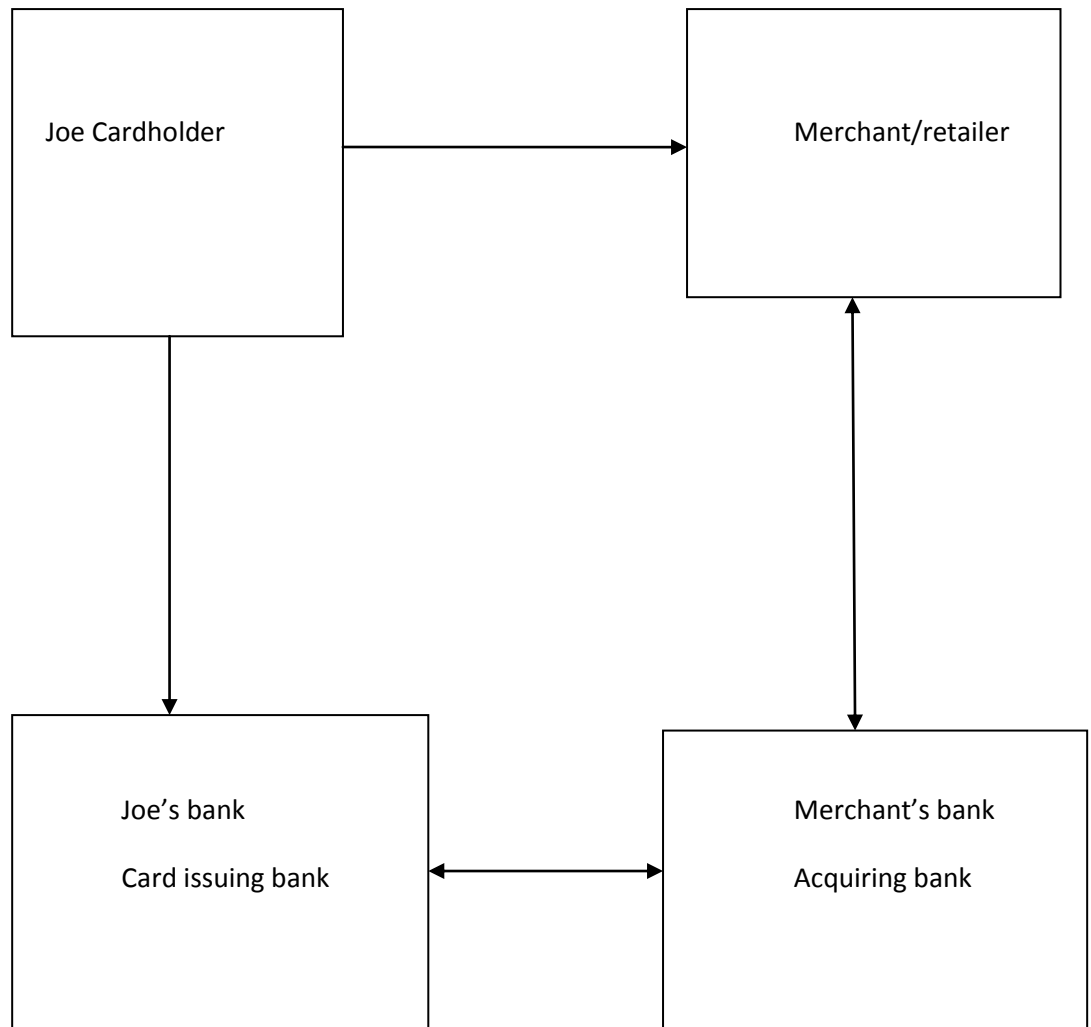
These questions arise especially in relation to the so called ‘multilateral interchange fees’ and ‘no-discrimination rules’ analysed in the following.

7.4 Multilateral Interchange Fees

It has been already appreciated that a card payment transaction generally involves different sub-transactions; a) Card Issuer- Card Holder, b) Merchant- Card Holder, c) Acquirer-Merchant, and d) Card Issuer-Acquirer. A credit card transaction typically involves four parties: the consumer, the retailer, the retailer’s bank (merchant acquirer) and the consumer’s bank (the card issuer).

It goes without saying that these transactions entail the payment of fees and of different types of charges. On processing any transaction, a fee is levied from the merchant acquirer to the card issuer, which is then passed on to the retailer, and ultimately the consumer. This fee is known as an interchange fee. It is set by the card issuers as a collective agreement between them and all the banks with whom they deal (hence the term multi-lateral interchange fee, hereafter ‘MIF’).

The diagram in the next page illustrates this situation.



- 1) The card issuing bank supplies Joe with a card.
- 2) When Joe buys a cup of coffee from the retailer, the card issuing bank charges his account with £1 plus fees. The fees may be an annual fee as well as a fixed amount or percentage on the transaction.
- 3) The card issuing bank pays the acquiring bank 98.5p, deducting a 1.5p interchange fee.
- 4) The acquiring bank pays the merchant 98p, charging 0.5p.

The “merchant’s discount” is $£1 - 98p = 2\%$.

It is not open to banks to negotiate individual fees with the credit card companies. Nevertheless, not all payment card systems ignite the use of multilateral interchange fees.

For instance, a card payment system in which all cardholders and merchants derive their card services from a unique financial organisation does not entail the existence of multilateral interchange fees⁴⁰². Examples of such card payment systems are American Express or Diners Club. In particular, American Express established and developed a network system based on a direct relationship between the card issuer (American Express), cardholders and merchants⁴⁰³.

This creates a so called ‘closed network’ within which the association deals directly with cardholders and merchants establishing the level of fees to be paid by these two groups⁴⁰⁴. In other words, American Express or Diners Club created a ‘three-party system’ imposing their pricing decisions vis-à-vis cardholders and merchants.

Such “direct” card systems are in open contrast with the interchange systems set up by Visa or MasterCard. Visa or MasterCard created network systems whereby

⁴⁰² On this point see S. Weiner and J. Wright, “*Interchange Fees in Various Countries: Developments and Determinants*”, 2005, at p. 6. Available at the following link: <http://www.kansascityfed.org/PUBLICAT/PSR/Proceedings/2005/Weiner-Wright.pdf>. (accessed on 20 July 2011).

⁴⁰³ *Ibid.* p.5. For a detail analysis of the American Express and Diners Club card payment systems see also R. S. Pindyck, “Governance, Issuance Restrictions, and Competition in Payment Card Networks”, Massachusetts Institute of Technology, June 2007, at p. 5. Available at the following link: <http://web.mit.edu/rpindyck/www/Papers/PaymentCardsRSPJune07WP.pdf>. (accessed on 20 July 2011).

⁴⁰⁴ For an economic analysis, see B. Klein; A.V.Lerner, K.M. Murphy, and L. Plache, “*Competition in Two-Sided Markets: The Antitrust Economics of Payment Card Interchange*” 2005-2006, 73 Antitrust L.J., p. 571. See also S. Weiner and J. Wright, “*Interchange Fees in Various Countries: Developments and Determinants*”, above, at p. 6. At the core of a ‘closed network’ lies the determination of the cardholder’s fees versus merchant’s fees. For instance American Express stated in 2004 to have received 71% of its card related revenues from merchants without charging any fees to cardholders (on this point see S. Weiner and J. Wright, “*Interchange Fees in Various Countries: Developments and Determinants*”, above, at p. 7).

their members (card-issuers and acquirers) supply card services to end users⁴⁰⁵. Under those systems, the founder associations do not deal directly with cardholders and merchants and are therefore prevented from determining the fees to be charged on these sides⁴⁰⁶. Visa or MasterCard systems involve four parties a) Card Holders, b) Merchants c) Card Issuer Bank and d) Merchants giving rise to a so called 'two sided market' in which the two end-user groups are cardholders and merchants⁴⁰⁷.

In such a scenario, multilateral interchange fees come into play as a means by virtue of which is possible to achieve a "desired balance of cardholder usage versus merchant acceptance across the two sides of the market"⁴⁰⁸. According to economic doctrine, through multilateral interchange fees it is possible to "transfer revenues from one side of the market to the other in order to generate the desired level of card activity"⁴⁰⁹.

A multilateral interchange fee can thus be defined as an interbank payment made for each transaction carried out with a payment card⁴¹⁰.

⁴⁰⁵ See S. Weiner and J. Wright, *"Interchange Fees in Various Countries: Developments and Determinants"*, above, at p. 7. See also A.S. Frankel and A.L. Shampine, "The economics effects of Interchange Fees", 73 Antitrust Law Journal No. 3 (2006).

⁴⁰⁶ Ibid. p.7.

⁴⁰⁷ See Fumiko Hayashi and Stuart E. Weiner, *"Competition and Credit and Debit Card Interchange Fees: A Cross-Country Analysis"*, Payments System Research Department - Federal Reserve Bank of Kansas City Working Paper 05-03 2005, at p. 3. Available at: http://www.unfaircreditcardfees.com/uploads/Competition_and_Credit_and_Debit_Card_Interchange_Fees.pdf. (accessed on 20 July 2011).

⁴⁰⁸ See S. Weiner and J. Wright, *"Interchange Fees in Various Countries: Developments and Determinants"*, above, at p. 8.

⁴⁰⁹ See Fumiko Hayashi and Stuart E. Weiner, *"Competition and Credit and Debit Card Interchange Fees: A Cross-Country Analysis"*, above, at p. 4.

⁴¹⁰ See H. Leinonen, *"The Efficiency Of Multilateral Interchange Fees"* The Bank of Finland - 08 May 2007, at p. 1. Available at the following link: <http://www.gtnews.com/article/6739.cfm>. (accessed on 20 July 2011).

In the Visa system, it is paid to the cardholder's bank by the retailer's bank and constitutes a cost for the latter which is normally passed on to retailers as part of the fee they pay to their bank for each Visa card payment. The default level of the Visa MIF, which applies unless two banks agree otherwise is set by the Visa Board and laid down in the Visa International payment card rules, have been notified to the Commission for clearance (see Press Release IP/02/1138).

On a general level, interchange fees may vary considerably and are usually determined on the basis of the different method of processing (i.e. paper based transactions or electronic payments), and the type of card used (i.e. consumer or commercial corporate cards)⁴¹¹.

As analysed in the following, multilateral interchange fees can also be set on different levels on the basis of International or Domestic Schemes. At international level, the MasterCard and Visa systems, the member banks or representatives acting on their behalf usually determine the interchange fees⁴¹². In a parallel way, domestic interchange fees are generally established locally by a board of member banks⁴¹³. Domestic multilateral interchange fees may therefore be defined as transactions taking place in the country where the card was issued⁴¹⁴.

The Commission points out in its *Interim Report on Payment Cards* that this sort of ‘double-system’ of International and Domestic multilateral interchange fees is structured in such a way to create a “fallback” effect. By virtue of this “fallback” effect, in the absence of an agreement between member banks, there is always “an interchange fee that acquirers pay to issuers, whether a multilaterally agreed default rate at local level or a multilaterally agreed cross-border fee; this excludes the possibility that acquirers pay no interchange fees to issuer”⁴¹⁵.

In substance, it has been correctly noted that MIFs are nothing other than a “commonly agreed price at the interbank level and therefore a blatant price-fixing

⁴¹¹ For a detailed analysis see the “*Commission’s Interim Report on Payment Cards*”, Sector Inquiry under Article 17 Regulation 1/2003 on retail banking, 12 April 2006, at p. 18. The report is available at the following link: http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/financial_services/ (accessed on 20 July 2011).

⁴¹² *Ibid.*, at p. 19.

⁴¹³ *Ibid.*, at p. 19.

⁴¹⁴ *Ibid.*, at p. 20.

⁴¹⁵ See the “*Commission’s Interim Report on Payment Cards*”, above, at p. 19.

device”⁴¹⁶. It goes without saying that, due to their multilateral price-fixing character, MIFs raise serious competition concerns. These concerns will be analysed in the following.

7.5 MIFs and EU Competition Law

A multilateral interchange fee is usually determined by groups of service providers for interbank transfers of a given payment instrument⁴¹⁷. In substance, MIFs are mainly used in order to transfer revenues/charges from the acquiring (merchant’s) bank or institution to the issuing (cardholder’s) bank or institution⁴¹⁸.

As emphasised by the Commission, agreements determining interchange fees on a general level, “lead to a transfer of revenues from acquirers to issuers and thereby distort price competition between acquiring banks”⁴¹⁹. The Commission puts emphasis also on the *quasi* tax effect that interchange fees have on each payment with a card at a merchant outlet⁴²⁰.

Since MIFs are jointly determined by service providers in competition with one another within the same market, they can be thus considered as blatant price fixing practice⁴²¹ capable *per se* of infringing Art. 85 (1) (now Art. 101 (1) TFEU).

7.6 The Early Commission’s Decisions relating to MIFs

Since the outset of the European Union, the legality of MIFs has been under the scrutiny of the Commission through a series of investigations and decisions. In the

⁴¹⁶ See Faull & Nikpay, “*The EC Law of Competition*”, above, p. 643.

⁴¹⁷ See H. Leinonen, “*The Efficiency Of Multilateral Interchange Fees*”, above, at p. 1.

⁴¹⁸ *Ibid.*, at p. 1,

⁴¹⁹ See the “*Commission’s Interim Report on Payment Cards*”, above, at p. 32.

⁴²⁰ *Ibid.*, at p. 32.

⁴²¹ See H. Leinonen, “*The Efficiency Of Multilateral Interchange Fees*”, above, at p. 1.

aforementioned *Uniform Eurocheques - Package Deal*⁴²², the object of controversy was the agreements relative to the governing rules of the Eurocheque System, creating a system of MIF. The agreements in question were considered necessary for the correct functioning of the system and clearance was granted.

This *raison d'être* was reiterated in *Association Belge des Banques (ABB)*⁴²³, in which the Commission was asked to assess, *inter alia*, two different payment systems giving rise to MIFs (one related to the handling of security transactions, and the other arising from the processing of cross-border payments). Just like in *Uniform Eurocheques- Package Deal*, the payment system related to the handling of security transactions was exempted on the basis of essentiality and transactions cost arguments⁴²⁴.

Another exemption was granted in the subsequent Commission decision in *ABI*⁴²⁵. In this case, the MIFs arose from various payment systems notified by the Italian banking association. It has been correctly noted that this decision contains an obiter dictum implying that MIFs on a general level restrict competition and therefore are per se caught by Art. 85 (now Art. 101)⁴²⁶.

MIFs were the object of the dispute yet again in *Dutch Banks I*⁴²⁷. This time the outcome of the decision was different, as the Commission acknowledged that the banks involved in the payment system under scrutiny were incapable of proving that

⁴²² See the Commission's decision in *Uniform Eurocheques*, above.

⁴²³ Commission's Decision, *Association Belge des Banques (ABB)* 9/01/1987, OJ L7/27.

⁴²⁴ On this point see the observations made by L. Gyselen, "*EU antitrust Law in the Area of Financial Services*", above, at p. 8.

⁴²⁵ Commission's Decision, *ABI* 13/02/1987, OJ L 43/51.

⁴²⁶ On this point see Luc Gyselen, "*EU antitrust Law in the Area of Financial Services*", above, at p. 8. See the Commission's decision in *ABI*, above, at paragraph 28. At this paragraph, the Commission emphasises that "*the fixing of interbank commissions (namely MIFs)...influences the possibility for parties to determine the conditions they wish to apply to their customers in the light of their internal profitability situation- notably the cost of the operations- their specialisation and their business policy*".

⁴²⁷ Commission's Decision, *Dutch Banks* 30/08/1989, OJ L 253/1.

such agreements on inter-bank commissions were actually necessary for the successful implementation of certain forms of cooperation, , between a number of banks.

The overall position of the Commission arising from the above decisions appear to be therefore that only in exceptional cases, i.e. where a compelling necessity for forms of inter-bank co-operation is established, agreements on inter-bank commissions may be worthy of exemption under Art, 85 (3) (now Art. 101(3))⁴²⁸. Essentiality appears, thus, to represent a necessary pre-requisite for the exemption of MIFs.

The detrimental effect of MIFs on competition was subsequently emphasised in *Eurocheque Package Deal II*⁴²⁹. With this decision, the Commission refused to renew the exemption granted to the *Eurocheque Package Deal I*, on the basis of two main reasons. The first reason was to be found in the fact that some banks part of the system systematically paid an interchange fee equal to the maximum amount of MIF determined by the Eurocheque system⁴³⁰. Secondly, the Commission found that all the banks participating in the network in practice ultimately passed the cost of the MIFs on to their clients⁴³¹.

The Commission decision not to renew the exemption for MIF in *Eurocheque Package Deal II*, has been considered idiosyncratic and therefore object of criticism. This in view of the fact that the knock-on effect of the MIF in the relationship

⁴²⁸ See the Commission's Decision in *Dutch Banks*, above, at paragraph 26. The Dutch Banks appealed the Commission's decision, nevertheless the CFI rejected the appeal which was considered inadmissible. See Case T-138/89 *Nederlandse Bankiersvereniging and Nederlandse Vereniging van Banken v. Commission* [1992] ECR II- 2181.

⁴²⁹ Commission's Decision, *Eurocheque : Helsinki Agreement*, 25/03/1992, OJ L 95/50.

⁴³⁰ See the Commission's Decision in *Eurocheque : Helsinki Agreement*, above, at paragraph 12. On this point see the observations made by L. Gyselen, "EU antitrust Law in the Area of Financial Services", above, at p. 8.

⁴³¹ *Ibid.*, at paragraph 19.

between bank and cheque holder is indeed caught by Art. 85 (1) EC (now Art.101 (1), but should have deserved an exemption under Article 101 (3)⁴³².

In other words, the idea would be that although the MIF in *Eurocheque Package Deal II* indeed ultimately reverberated against clients, this should not necessarily mean that this phenomenon is not inherently necessary for the entire system to be functional, and therefore capable of being exempt under Article 101 (3)⁴³³.

This line of reasoning, with respect, does not appear very convincing. It is undoubtedly true that Article 101(3) provides for the possibility for an exemption of agreements/concerted practices capable of distorting competition whenever they are necessary to promote technical or economic progress. Nevertheless, although the Eurocheque System may be considered as a means of economic progress, another essential condition that must be fulfilled in order to obtain an exemption under article 101 (3) is that consumers must be capable of sharing the beneficial effect of such system. The fact that the MIF was in this case systematically passed on to end users appears to represent a worthy argument against the concession of an exemption.

The same rationale for the exemption of the MIFs in *Eurocheque Package Deal II*, was later applied in the statement of objection released by the Commission in *Dutch Banks II*⁴³⁴. In this case, the objection was based on the evidence that such a system was capable of operating (although in a less integrated way) before the introduction of the MIF. It has been correctly noted that yet again, the Commission

⁴³² See Luc Gyselen, “EU antitrust Law in the Area of Financial Services”, above, at p. 13..

⁴³³ *Ibid.*

⁴³⁴ Commission’s statement of objection, *Dutch Banks II*.

strongly relied on the systematic knock-on effect of MIFs on customers, as it did in *Eurocheque Package Deal II*⁴³⁵.

This line of reasoning, nevertheless, leaves an important issue open to debate: can MIFs without systematic knock-on effects be exempted? In other words, is the Commission prepared to grant an exemption in case MIFs are not passed on to customers, or can an exemption be granted only if MIFs are indispensable for the correct function of a specific payment system? And assuming that MIFs are indispensable for the functioning of a payment system, is the Commission inclined to grant exemption in case of the presence of knock-on effects?

7.7 The post -Eurocheque Package Deal II scenario and the Commission's Notice on cross-border transfers.

Endeavouring to answer the above questions, the Commission issued in 1995 a Notice on cross-border transfers⁴³⁶.

The Notice dealt in first place with the question of the compatibility of MIFs with Art. 101(1). This question is structured in three main points: the first point revolves around the impact of MIFs on the so called 'interbank market'⁴³⁷; the second point is connected to the effects of MIFs on competition among banks; and the third point deals with the effects of MIFs on competition between different payment systems.

With regard to the impact of MIFs on the interbank market, the Commission states that MIFs "restrict freedom of action of banks individually to decide their own

⁴³⁵ See Luc Gyselen, "*EU antitrust Law in the Area of Financial Services*", above, at p. 13.

⁴³⁶ Notice on the application of the EC Competition rules to cross-border credit transfers [1995] OJ C251/3.

⁴³⁷ On this point see Luc Gyselen, "*EU antitrust Law in the Area of Financial Services*", above, at p. 15.

pricing policies”⁴³⁸. This statement is not backed up by further explanations related to the effects of MIFs on the interbank systems and to the reasons why this should represent an infringement of Art. 101(1). Criticism was inevitably raised especially in relation to the notions of ‘freedom of actions’ and ‘individual pricing policies’⁴³⁹. These notions has been labelled as hollow concepts since “market forces do not play any rules at interbank level”⁴⁴⁰. In particular, the core argument of this criticism lies in the conviction that MIFs are inherent to payment systems. In other words, in order to correctly function, payment systems require the existence of MIFs. Or, as Gyselen points out “to put it in orthodox antitrust jargon: MIFs are ancillary restraints to an otherwise legitimate cooperative arrangement”⁴⁴¹.

In order to deny the existence of any interbank markets, it has been noted that the relationship between banks within the framework of a payment system is “merely one between cooperating partners who have adhered to a particular payment system cooperating for the benefit of their respective clients”⁴⁴².

Furthermore, it has been submitted that the banks participating in a payment system do not choose each other; the reason for this lies in the fact that banks find themselves cooperating with each other as a consequence of the initiation of a transaction for which a payment is due⁴⁴³. To put it in a different way, these banks are “obligatory partners to each other”⁴⁴⁴. In light of the thereof, one could claim that

⁴³⁸ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 12 (emphasis added).

⁴³⁹ On this point see Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 15.

⁴⁴⁰ *Ibid.*

⁴⁴¹ On this point see Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 15.

⁴⁴² See Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 15.

⁴⁴³ *Ibid.*

⁴⁴⁴ *Ibid.*

a hypothetical free market activity at interbank level would arguably result in a breaking point for the entire payment system.

In a typical free market activity, banks would be able to negotiate freely the price of the MIFs essential for the processing of transaction payments. Such negotiation could ultimately lead to the request for excessively high MIFs that banks owing them would not be prepared to pay. All this would result in the freezing of payment transactions and the consequent erosion of the payment system.

The second element taken into account by the Commission in the Notice regarding the compatibility of MIFs with Art. 101, is the impact of such fees on intra system competition. The Commission expresses its concern stating that MIFs “are likely to have the effect of distorting the behaviour of banks vis-à-vis their customers”⁴⁴⁵. Such concerns were not new and was already at the core of previous Commission’s Decisions or statements of objections⁴⁴⁶. Nevertheless, it has been interestingly pointed out that beyond the Commission’s concern regarding the behaviour of banks *vis-à-vis* their customers, lied the idea of possible consequent restrictions on intra-system competition⁴⁴⁷.

From this perspective, the main concern would be that MIFs may become a sort of “uniform floor in the all bank’s client commissions”⁴⁴⁸ compressing therefore “the margins within which they indulge in price-competition”⁴⁴⁹. Evidence of such parallel conduct was found by the Commission in *Eurocheque Package Deal II* and

⁴⁴⁵ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 19 (emphasis added).

⁴⁴⁶ See the Commission’s decision in *Eurocheque Package Deal II*, above, and the Commission’s statement of objection in *Dutch Banks II*, above.

⁴⁴⁷ See Luc Gyselen, “EU antitrust Law in the Area of Financial Services”, above, at p. 16.

⁴⁴⁸ *Ibid.*

⁴⁴⁹ *Ibid.*

Dutch Banks II, and held against the banks participating in the payment systems at issue.

The main criticism to this evaluation of the Commission lies in the fact that no competition issues may arise as long as the banks participating in a specific payment system have not explicitly agreed with one another to revert MIFs vis-à-vis their clients. The line of reasoning of the Commission seems clear on this point: in its Notice, it is stated that “there will be a restriction of competition under Art. 101(1) when there is an agreement or concerted practice between banks to pass on the effect of the interchange fee in the prices they charge their customers”⁴⁵⁰.

The Commission appears, thus, to emphasised that in light of Art. 101(1), it is not necessary to have an official agreement capable of restricting or distorting the competition in order to violate the EU antitrust law; a concerted practice (i.e. a collusive behaviour among undertakings) would do. In other words, whenever MIFs are *de facto* passed on by banks to their customers, such MIFs cause a restriction on intersystem competition between banks participating in a payment system, and violate Art. 101(1). On the contrary, whenever no evidence of such pass-on practices is provided, it becomes difficult to maintain that MIFs somehow hinder competition within the framework of a bank-customer relationship⁴⁵¹.

It has been correctly noted that the absence of such evidence appears to indicate that “MIFs have been absorbed into the overhead costs of the banks participating in a specific payment system”⁴⁵². As a result, this ‘cross subsidisation’ would lead to a distortion of the “natural allocation of costs between banking

⁴⁵⁰ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 19 (emphasis added).

⁴⁵¹ See Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 17.

⁴⁵² *Ibid.*

services, but Art. 101 does not prevent banks from causing such distortion as long as they decide independently to do so”⁴⁵³.

The third point taken into account by the Commission in its Notice relates to the effects of MIFs on the intersystem competition. The Commission notes that “sufficiently strong intersystem competition could restrain the effects of the interchange fee on the prices charged to customers...provided that the competing systems do not themselves also contain similar multilateral interchange fees”⁴⁵⁴.

Invariably, the concept of intersystem competition needs to be addressed in relation to the relevant market at issue. The Commission in first place emphasises that in case of cross-border payment transactions, it is necessary to identify possible alternatives in terms of payment instruments⁴⁵⁵. In second instance, the Commission acknowledges that within the category of cross-border transactions “there may well be separate narrower markets depending on the value of the payment, the type of beneficiary or the required speed for the execution of the payment”⁴⁵⁶.

Finally, the Commission stresses the need to consider on a case-by-case basis the “cross-border credit transfers (or particular segments, such as retail cross-border credit transfers) as the relevant market”⁴⁵⁷.

7.7.1 Possibility of Exemption under Art. 101(3)

As analysed above, according to the Commission MIFs may give rise to competition concerns falling within the scope of Art. 101(1) whenever:

⁴⁵³ *Ibid.*

⁴⁵⁴ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 19 (emphasis added).

See Luc Gyselen, “*EU antitrust Law in the Area of Financial Services*”, above, at p. 17.

⁴⁵⁵ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph..

⁴⁵⁶ *Ibid.*

⁴⁵⁷ *Ibid.*

- a) A MIF is capable of reducing the freedom of banks to determine their own price policies⁴⁵⁸;
- b) A MIF reverts against intra-system competition with a negative impact on the behaviour of banks vis-a-vis their clients⁴⁵⁹; and
- c) A MIF restricts or hinders inter-system competition.

With regard to the exemptibility of MIFs under Art. 101(3), the Commission's Notice distinguishes between SHARE and BEN payments and OUR payments. In cross-border payments, customers are usually offered one of the three above choices to pay⁴⁶⁰. In SHARE transfers, the fees are shared by sender and receiver, whereas in BEN transfers all fees relating to the transfer should be charged to the receiver, at the request of the sender. Finally in OUR transfers all fees are charged to the sender. This distinction appears to be largely influenced by the Commission's Decisions in *Eurocheque Package Deal I* and *II*.

In substance, when it comes to a possible exemption under Art. 101(3) doubts arise on the Commission's part in relation to the indispensability of MIFs for the

⁴⁵⁸ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 41.

⁴⁵⁹ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 41.

⁴⁶⁰ Under Directive 1997/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers (OJ L 043/25, 14/02/1997), although the terms do not appear in the text itself, all three options for the sharing of charges between the originator and the beneficiary are available, with OUR as the default option. The setting of OUR as the default was intended to ensure price transparency thus avoid double charging and to ensure the arrival of the full amount transferred on the account of the beneficiary.

However, at national level the distinction between "OUR", "SHARE" or "BEN" payments hardly exists and "SHARE" is usually the only available option. Consequently, cross-border payments in Euro below EUR 50,000 are also executed, by default, as "national SHARE".

Regulation (EC) No 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro (OJ L 344/13, 28.12.2001) overrules Directive 1997/5/EC as regards charging rules, and therefore, the provisions of the Directive only remain applicable to payments that are not covered by the Regulation.

current functioning of payment systems where the transfer is SHARE or BEN. Such systems, as a matter of fact, denote a natural inclination to pass MIFs on to clients⁴⁶¹.

The message is thus loud and clear: MIFs cannot benefit from exemption in case it is possible for the banks receiving them to obtain a sort of “double compensation” (one from the sender’s bank or its correspondent and one from their clients⁴⁶²).

The Commission’s approach is radically different in relation to MIFs for OUR transfers. The *raison d’être* here recalls *Eurocheque Package Deal II* rationale: whenever beneficiary banks part of a payment system processing OUR transfers are not in the position to recover any costs from their clients, MIFs fall within the meaning of Art. 101(3), and are, thus, exemptible⁴⁶³.

The Commission’s Notice pushed the boundaries for the exemption further if compared to its Decision in *Eurocheque Package Deal II*: according to the Notice, banks wishing to obtain an exemption for MIFs in relation to OUR transfer systems are required to justify them by reference to incurred costs⁴⁶⁴. In addition, the Commission requires the MIFs to be a “default fee allowing members of the system to negotiate bilateral fees below the reference level”⁴⁶⁵. This last requirement appears to denote the necessity on the Commission’s part to emphasise the need for a

⁴⁶¹ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 45. Yet again, a parallel with *Eurocheque Package Deal I and II* can be easily drawn.

⁴⁶² For a more detailed analysis see Luc Gyselen, “EU antitrust Law in the Area of Financial Services”, above, at p. 18.

⁴⁶³ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 46.

⁴⁶⁴ *Ibid.*, at paragraph 47. Banks are under the duty to demonstrate that: a) the beneficiary’s bank of the MIFs carries out one or more functions related to cross-border transfers; b) they are bound to be the recipients of MIFs; and c) the entity of the MIFs corresponds to the level of the average additional costs of participating banks operating as beneficiary’s banks.

⁴⁶⁵ See the Notice on the application of the EC Competition rules to cross-border credit transfers, above, at paragraph 46.

minimum level of competition without which is difficult to accept the idea of an exemption.

7.8 The Commission's Decision in *Visa International-Multilateral Interchange Fee* 2002

In recent years, the Commission had the chance to apply the line of reasoning established in its Notice on the application of the EU Competition rules to cross-border credit transfers to the MIFs arising from the Visa payment system⁴⁶⁶.

The issue object of dispute was in this case the MIF relating to the multilateral interchange fees for cross-border payments with Visa cards. The default level of the Visa's MIF which applies unless two banks agree otherwise was set by the Visa Board, and laid down in the Visa International payment card rules, which have been notified to the Commission for clearance⁴⁶⁷.

In September 2000, the Commission released a formal statement of objection to the current Visa MIF.⁴⁶⁸ After long discussions with Visa, a proposal for a modified MIF scheme was submitted to the Commission, enabling Visa to obtain an exemption under Article 101(3) of the EU treaty.⁴⁶⁹

The key elements of the modified MIF scheme which triggered the exemption⁴⁷⁰ were essentially three: a) a progressive reduction of the level of the

⁴⁶⁶ Commission Decision, *Visa International-Multilateral Interchange Fee*, Case No COMP/29.373, 2002/914/EC of 24 July 2002.

⁴⁶⁷ The MIF was introduced by Visa in 1974 (at that time called Ibanco Ltd.). In 1981 a specific MIF for intra-regional transactions in EU was introduced in conjunction with the creation of a separate administrative system covering the EU.

⁴⁶⁸ See press release IP/00/1164.

⁴⁶⁹ Until the Visa's proposal for a modified MIF scheme, the average level of the MIF had been gradually increased during the years.

⁴⁷⁰ The exemption is due to expire on 31 December 2007, after which date the Commission will be free to re-examine the Visa MIF system, in the light of the effects of the revised MIF on the market.

intra-regional MIFs for different types of cards⁴⁷¹; b) secondly, the MIF was capped at the level of costs for certain specific services provided by issuing banks, which in the Commission's view corresponded to services provided by cardholders' banks which benefit those retailers who ultimately pay the cross-border MIF⁴⁷²; and c) finally, Visa agreed to allow member banks to disclose information about the MIF levels and the relative percentage of the three cost categories (currently considered business secrets) to retailers at their request. Retailers were supposed to be informed of this possibility⁴⁷³.

The new version of Visa MIF was weighed up by the Commission only within the context of cross-border payments⁴⁷⁴. The Commission appreciated the necessity of some forms of default agreements on exchange terms between issuers and acquirers within the framework of an international payment card system, as bilateral negotiations between all the member banks would lead to cost increment and inefficiencies.

In line with previous case-law on MIFs and its Notice on the application of the EU Competition rules to cross-border credit transfers, the Commission maintained that the multilateral setting of the Visa MIF between competing banks constitutes indeed a restriction of competition.

⁴⁷¹ See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 17. As concerns Visa's deferred debit card and credit card payments, the weighted average MIF rate was brought down in stages, to a level of 0.7% in 2007. For debit card transactions Visa introduced immediately a flat-rate MIF of €0.28.

⁴⁷² See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 21. These services are: transaction processing, payment guarantee and free funding period. These were determined by a cost study, to be carried out by Visa and audited by an independent accountant approved by the Commission. This ceiling applied regardless of the reductions in the level of the MIF offered by Visa (that is, if the cost cap is below 0.7%, then the MIF will have to be below 0.7%).

⁴⁷³ See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 25.

⁴⁷⁴ See Press Release IP/02/1138.

Nevertheless, the Commission concluded that a multilaterally-fixed interchange fee may indeed lead to beneficial efficiencies and economies within a payment network, and therefore can benefit from an exemption, but only if it is set in a reasonable and equitable manner.

The two concepts of reasonability and equitability were not defined, arguably on purpose. This allows the Commission not only to determine on a case by case basis whether the three conditions laid down in the Notice are fulfilled, but also to assess future scenarios with a large degree of discretion arising from these vague concepts of reasonability and equitability.

7.9 The recent Commission Decisions in MasterCard intra-EEA fallback interchange fee

MIFs have yet again been the object of scrutiny on 19 December 2007, when the European Commission interestingly declared that the MasterCard's MIF for cross-border payment card transactions with MasterCard and Maestro branded credit cards infringed Article 101⁴⁷⁵. The Commission maintained that MasterCard's MIF, inflated the cost of card acceptance by retailers without leading to proven efficiencies.

It is of great necessity to specify *a priori* that the recent Commission Decision is far from representing a general *reprimenda* of all MIFs; it, indeed, takes into account only one specific MIF operating within the MasterCard payment card system, the so called "intra-EEA fallback interchange fee". This specific MIF is

⁴⁷⁵ Commission Decision of 19 December 2007 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement (Case COMP/34.579 — MasterCard, Case COMP/36.518 — EuroCommerce, Case COMP/38.580 — Commercial Cards) MasterCard intra-EEA fallback interchange fee, 19/12/2007, OJ C 264/8.

ignited by cross-border card payments with MasterCard and Maestro cards, and by domestic payments in some Member States. Furthermore, the decision prohibits the "intra-EEA fallback interchange fee" only in relation to consumer credit and debit cards but not insofar as it involves commercial (e.g. corporate) cards⁴⁷⁶.

The MasterCard's MIF under scrutiny was considered by the Commission as a mechanism capable of hindering price competition between acquiring banks by artificially inflating the basis on which these banks charge merchants.

According to Commission's estimates, MasterCard's MIF amounted to more than 70% of the merchant service charges for credit cards in Belgium (2002) and for approximately 60% of these charges in Italy (2003)⁴⁷⁷. Without this MIF, merchants were deemed to pay lower prices for accepting cards and, accordingly, customers should have incurred lower costs⁴⁷⁸.

The Commission did not consider MasterCard's MIF eligible for an exemption under Article 101(3). The main reason for this is that the MIF was deemed to operate with unrealistic assumptions, and MasterCard failed to submit empirical evidence to demonstrate any positive effects of its MIF on the market⁴⁷⁹. In other words, the value of the MIF was found to be artificially inflated and did not correspond to the effective recovery costs necessary in order to process card payment

⁴⁷⁶ See the Commission *Press Release on the Decision MasterCard intra-EEA fallback interchange fee*, MEMO/07/590, available at the following link:

<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/590&format=HTML&aged=0&language=EN> (accessed on 20 July 2011).

Singularly, the Press release of the Commission contains, in this case, a more detailed analysis than the Decision itself which was realised at a later date. That is the reason why in the following quotes of the Press Release will appear on a *pari passu* basis with extracts from the Decision.

⁴⁷⁷ *Ibid.* .

⁴⁷⁸ See the Commission's *Press Release on the Decision MasterCard intra-EEA fallback interchange fee*, above.

⁴⁷⁹ *Ibid.* See Commission Decision *MasterCard intra-EEA fallback interchange fee*, above, at paragraph 25.

transactions. As a result, the Commission maintained that MasterCard's MIF rendered card payments artificially more expensive⁴⁸⁰.

Further, in carrying out the assessment of the compatibility of MasterCard Europe MIF with Art. 101 (3), the Commission claimed to have attributed particular importance to the question whether in setting the intra-EEA fallback interchange fee MasterCard used a 'methodology' that guaranteed from the outset that both cardholders and merchants obtain a fair share of eventual benefits⁴⁸¹. MasterCard, in practice, was found to set the level of its MIF using "cost benchmarks"; however, the outcome of the Commission's investigation was that these benchmarks were "largely arbitrary and inflated"⁴⁸². In the absence of evidence to the contrary, the Commission could not safely assume that by pursuing its member banks' aim of maximising sales volumes, MasterCard's MIF created efficiencies that benefit *all* customers, including merchants.

On the basis of these considerations, the Commission declared the MasterCard's MIF incompatible with Article 101 (3) of the EC Treaty⁴⁸³.

The reaction of MasterCard to the Commission Decision did not take long: a Press Release was issued announcing the immediate recourse to appeal the Decision

⁴⁸⁰ Due to the lack of empirical evidence submitted by MasterCard, the Commission was not in a position to balance these negative effects of the MIF vis-à-vis possible objective efficiencies. See Commission Decision *MasterCard intra-EEA fallback interchange fee*, above, at paragraph 25.

⁴⁸¹ See the Commission's *Press Release on the Decision MasterCard intra-EEA fallback interchange fee*, above. See Commission Decision *MasterCard intra-EEA fallback interchange fee*, above, at paragraph 23.

⁴⁸² See the Commission's *Press Release on the Decision MasterCard intra-EEA fallback interchange fee*, above. See Commission Decision *MasterCard intra-EEA fallback interchange fee*, above, at paragraph 23.

⁴⁸³ On the basis of the decision, MasterCard had six months time to cease applying its current intra-EEA fallback interchange fees for consumer credit and debit cards and to refrain from adopting measures having a similar effect. This also implies that MasterCard cannot apply its recently adopted SEPA/intra-Eurozone fallback interchange fees to payment transactions within the Eurozone. No fine was imposed.

before the Court of First Instance (now General Court)⁴⁸⁴. MasterCard believed to have solid grounds for its appeal. In particular, the firm conviction that market forces, not regulation, should drive key decisions such as the setting of interchange fees and retailers' choices over which forms of payment to accept, is accompanied by strong statements on the necessity of MIFs as balancing mechanisms in order to fairly share costs among all the participants in a payment system⁴⁸⁵.

7.10 The Commission's Decision in *Visa International-Multilateral Interchange Fee 2002* and the Decision on MasterCard on intra-EEA fallback interchange fee: two faces of the same coin?

It is inevitable to re-consider the recent Commission *Decision on MasterCard MIF* in light of the previous *Visa MIF Decision* of July 2002. The first striking difference between these two decisions is, of course, the outcome. If in 2002 the Commission granted a five years exemption to the Visa MIF, it was not prepared to do the same in relation to the MasterCard intra-EEA fallback interchange fee.

The main issue to be assessed here is whether this difference in terms of outcome is the result of a different approach possibly indicating a new trend, or if the Commission applied the same line of reasoning to both cases, reaching opposite conclusions due to the different circumstances underlying the two MIFs.⁴⁸⁶

The Commission asserts to have adopted exactly the same line of reasoning to both Decisions, the starting being that MIFs as a price fixing type of agreements

⁴⁸⁴ The MasterCard Press release is available at the following link:

http://www.mastercard.com/us/company/en/newsroom/pr_EC_Ddecision_Press_Release_Statement_191207.html. (accessed on 20 July 2011).

⁴⁸⁵ See the MasterCard *Press Release*, above. The decision of the General Court is still pending.

⁴⁸⁶ Yet again, it must be emphasised that at this stage the analysis at this stage inevitably lacks of depth due to the current non availability of the official text of the recent Commission's Decision relating to the MasterCard MIF. The above observations are founded on the Commission *Press Release on MasterCard MIF*.

are caught by Art. 101. In light of Art 101(3), the validity of the relevant MIF was then assessed *vis-à-vis* the empirical proof that the MIF creates efficiencies that outweigh the restriction of competition, that there are no less restrictive means of achieving the efficiencies, and that consumers are capable of obtaining a fair share of those benefits.

Due to the overall lack of empirical evidence supported by MasterCard, the Commission in that case acknowledged to have put more emphasis on the analysis of the MIF intended as an instrument aiming at “internalising network externalities in order to increase system output”⁴⁸⁷.

The Commission did not dispute, as a matter of principle, that such interchanges fees “may yield efficiencies which rest on the importance of network effects on both sides of the markets”⁴⁸⁸. However, it was emphasised that an imbalance of network externalities must be “carefully assessed on the basis of empirical evidence including both cost and revenue data related to providing payment services that fall respectively on issuing and acquiring, the willingness to pay of cardholders and merchants (elasticities) and the competitive conditions on both sides of the scheme”⁴⁸⁹.

In order to benefit from exemption, such MIFs must therefore be based on a detailed, robust and compelling analysis that relies in its assumptions and deductions on empirical data and facts showing an effective correspondence between the level of the MIF and the real cost recovery needs.

⁴⁸⁷ See the Commission’s *Press Release on the Decision MasterCard intra-EEA fallback interchange fee*, above.

⁴⁸⁸ *Ibid.*

⁴⁸⁹ *Ibid.*

The lack of empirical evidence of the linkage between MIF and recovery costs in the MasterCard case therefore empowered the Commission to develop its analysis further compared to the Visa Decision.

An interesting element of this analysis is represented by the Commission's statement that a "mere increase in a scheme's system output alone without at the same time benefiting the scheme's users (that is cardholders and merchants as well as their customers) cannot be considered as an objective efficiency within the meaning of Article 81(3) of the EC Treaty (now Art.101 93 TFEU)"⁴⁹⁰. The lesson to be learnt is that "any methodology to set a MIF should therefore from the outset ensure that a fair share of the benefits is granted to the final users of a card scheme"⁴⁹¹.

In light of the above, the recent MasterCard decision should arguably not be regarded as a general change of approach of the Commission in relation to the compatibility of MIFs with EU competition law. The underlying principles remain the same as in *Visa MIF 2002*: MIFs indeed have anticompetitive effects and they need to be assessed under Art. 101 (3) in order to evaluate the possibility of an exemption. If the *methodology* of the application of MIFs from the outset guarantees of their application that they represent a necessary means for recovering the effective transaction costs of card payments, and that both cardholders and merchants obtain a fair share of eventual benefits, an exemption will be granted.

A very interesting point to be extrapolated from the recent MasterCard Decision is that the Commission is strictly monitoring the real impact of MIFs focusing on consumer protection. Here seems to lay the common thread between the two Decisions: in the *Visa* case, the Commission clarified that MIFs in order to

⁴⁹⁰ See the Commission's *Press Release on the Decision MasterCard intra-EEA fallback interchange fee*, above.

⁴⁹¹ *Ibid.*

qualify for an exemption under Art. 101(3) need to reflect the effective transaction costs of card payment systems. With the *MasterCard Decision*, the Commission appears to state clearly that it will not be prepared to tolerate artificially inflated MIFs, based on unrealistic assumptions, and ultimately not beneficial to consumers.

This explains the current state of play of the law. Invariably, authors still debate on the essence of MIFs, their necessity, and their real impact on competition. All this will be taken into account in the following, where the reasons pro and contra MIFs are carefully weighed in conjunction with suggestions for possible regulatory alternatives.

7.11 The Economic perspective: Arguments pro MIFS

As previously established, MIFs tend to represent blatant price fixing kind of agreements distorting the conditions of competition within the framework of the issuing and acquiring payment card systems.

Ought MIFs to be allowed then? And what are the reasons in support of their existence?

There are two broad economic rationales in support of the existence of MIFs: the first is that they are an essential condition of any payment system and therefore are inherent to them. The second *raison d'être* for MIFs is based on the idea of their necessity for the optimisation of inherent costs of payment systems, and on the conviction that MIF would be ultimately beneficial to cardholders and merchants alike.⁴⁹²

⁴⁹² See the MasterCard statement in *US Merchant Interchange Lawsuit*, available at: http://www.mastercard.com/us/company/en/newsroom/interchange_lawsuit.html (accessed on 20 July 2011).

7.11.1 Are MIFs essential conditions of any payment system?

On a general level, MIFs are paid to the cardholder's bank by the retailer's bank reflecting costs for the latter, which are thereafter normally passed on to retailers as part of the fee they pay to their bank for each card payment. Accordingly, economically MIFs can be defined as sort of “compensation vehicles”⁴⁹³ providing incentives for banks to issue more cards, acquired more merchants, enhancing thus the network system.

The essential line of reasoning for MIFs would then be that such fees are deemed necessary to ensure the effectiveness of the cooperation between the various parties involved in the card payment system, optimising the incentives in order to increase the network size. In practice, a scenario without MIFs would see each card issuer determining its own fees and each acquirer contracting its merchant fee to be charged against the merchant for its acquiring services. This is considered by some authors to be inefficient and cost consuming⁴⁹⁴.

MIFs would therefore come into play in order to trigger the so called ‘network effects’ acting not only as inducement for the expansion of the payment card system, but also as *condition sine qua non* for the existence of the system itself⁴⁹⁵.

⁴⁹³ See S. Semerato, “Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty”, GEO . MASON L. REV., Vol. 14:4, 2007, at p. 950. Document available at the following link: <http://www.gmu.edu>(accessed on 20 July 2011).

⁴⁹⁴ See D.S. Evans and R. Schmalensee, “The economics of Interchange fees and their Regulation”, 2005, at p. 79. Document available at the following link: <http://www.kansascityfed.org/PUBLICAT/PSR/Proceedings/2005/Evans-Schmalensee.pdf>(accessed on 20 July 2011).

⁴⁹⁵ In practice the system can survive only through its expansion. If Banks do not have incentives to expand the network, or fees negotiations are conducted by banks or merchants on an individual basis, the entire system would be destined to an end.

According to VISA, MIFs should not be considered as the price for specified services provided by issuers to acquirers or merchants⁴⁹⁶. Rather, MIFs should be interpreted as “transfer of costs between undertakings, which are cooperating in order to provide a joint service in a network characterised by externalities and joint demand”⁴⁹⁷.

MIFs could thus be defined as financial devices capable of neutralising the “imbalance between the costs associated with issuing and acquiring revenues coming from cardholders with a view to increasing the demand for and consequently the use of payment services”⁴⁹⁸.

It is submitted by VISA that without jointly determined MIFs the banks would not take into account, or too little account of the ‘positive externalities generated by their decisions’⁴⁹⁹. MIFs would thus enable payment systems to function most efficiently and effectively. In this regard, MIFs should fall, in Visa’s view, within the scope of application of the *Commission’s Guidelines on Horizontal Cooperation*⁵⁰⁰ which states that horizontal cooperation between “competing companies that cannot carry out the project or activity covered by the cooperation will not fall within Article 81(1) (now Art. 101 (1) because of its very nature”⁵⁰¹.

⁴⁹⁶ See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 14.

⁴⁹⁷ *Ibid.* Network externalities arise when a network effect is not internalized through a competitive mechanism. On this point see Australian Banker’s Association, “*ABA Supplementary Submission on the Network Effects and Setting of the Interchange Fees*, submission to the Reserve Bank of Australia-Inquiry into the Credit Card Systems”, September 2001, p. 1-2. Document available at the following link: http://www.rba.gov.au?Paymentssystem/PaymentPolicy?CreditCardSchemes/IIISubmissionsReceivedVolume1/G.4_aba_sub.pdf (accessed on 20 July 2011).

⁴⁹⁸ See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 14.

⁴⁹⁹ *Ibid.*

⁵⁰⁰ *Commission’s Guidelines on Horizontal Cooperation and the Applicability of article 81 of the EC treaty to Horizontal Agreements*, OJ C 3/2001.

⁵⁰¹ *Ibid.* at paragraph 24.

MIFs appear to be, therefore, *prima facie* inherently necessary for the current functioning of payment card systems; yet, serious concerns indeed arise in relation to their anticompetitive effects. The economic answer to these concerns would be that if contextualised in the optic of a two sided market, MIFs would not necessarily be the cause of anticompetitive anxiety⁵⁰².

As emphasised above, payment card systems operate in a two-sided market; within the framework of such systems there are two joint providers (the card issuer and acquirer) and two joint users (the cardholder and the merchant). Such markets are characterised by the need to compete for two different types of customers with “different elasticities of demand”⁵⁰³. Two-sided markets end up, thus, embodying peculiar network effects: in order to optimise outputs suppliers cannot necessarily “price each side at marginal cost plus normal profit”⁵⁰⁴.

On the contrary, it has been maintained that an increase in marginal cost on one side “does not necessarily result in an increase in price on that side relative to price on the other side.”⁵⁰⁵ Equilibrium and optimal pricing seems to depend from an economic perspective “on the price elasticities of demand of customers on sides, the network effects, and the marginal costs resulting from changing output on each

⁵⁰² On this point see D. S. Evans, “*The Entitrust Economics of Multi-sided Platform Markets*”, 20 Yale J. Reg. 325 (2003), at p. 625.

⁵⁰³ See S. Semerato, “*Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*”, above, at p. 950.

⁵⁰⁴ *Ibid.*, at p. 951. On this point see also D. S. Evans, “*The Entitrust Economics of Multi-sided Platform Markets*”, above at p. 625.

⁵⁰⁵ See D. S. Evans & M. Noel, “*Defining Antitrust Markets When Firms Operate Two sided Platforms*”, 2005 COLUM. BUS. L. REV. 667, at p. 681.

side”⁵⁰⁶. As a consequence, the pricing structure determination is destined to have a definitive impact on the final equilibrium of the system⁵⁰⁷.

From this perspective, in order to exist and efficiently perform, a payment card system must induce both cardholders to use cards and merchants to accept them⁵⁰⁸. The success of either markets will strictly depend on the other; the more consumers will use cards, the more merchants will be inclined to accept them and vice versa⁵⁰⁹.

Here seems to lay the peculiarity of payment card systems: payment card systems are two-sided markets, and two-sided markets are radically different from ordinary markets. Within the framework of an ordinary market, price fixing practices are generally anticompetitive and harmful for consumers.

On the contrary, it has been maintained that in a two-sided market collusive practices do not necessarily have a negative impact on competition due to the asymmetric platform competition characterising such markets⁵¹⁰.

In a payment card system, cardholders and merchants (the two joint users representing one side of the market) are likely to have differing demands for card services, as well as issuing and acquiring banks are likely to have differing cost configurations⁵¹¹. On a general level, one transaction side will be in the position to

⁵⁰⁶ See S. Semerato, “*Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*”, above, at p. 951. See also D. S. Evans & M. Noel, “*Defining Antitrust Markets When Firms Operate Two sided Platforms*”, 2005 COLUM. BUS. L. REV. 667, at p. 681.

⁵⁰⁷ See B. Klein, “*Competition in Two-Sided Markets: The antitrust Economics of Payment Interchange Fees*”, 73 ANTITRUST L.J. (2006), at p. 577.

⁵⁰⁸ On this point see A.S. Frankel and A. L. Shampine, “*The Economic effects of Interchange Fees*”, 73 Antitrust Law Journal No.3 (2006), at p. 630.

⁵⁰⁹ See S. Semerato, “*Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*”, above, at p. 951.

⁵¹⁰ On this point see R. Roson, “*Two Sided Markets: A Tentative Survey, Review of Networks Economics*”, Vol.4, Issue 2, June 2005, at p. 154. Document available at the following link: http://www.rnejournal.com/articles/rosen_RNE_june05.pdf (accessed on 20 July 2011).

⁵¹¹ See W.F. Baxter, “*Bank Interchange of Transactional Paper: Legal and economic Perspectives*”, 26 J.L. & ECON. 541 (1983), at p. 586.

recover more than its costs, due to the elastic nature of the demand of the consumers on that side⁵¹².

MIFs would then be the right tool in order to achieve an optimal balance capable of satisfying the demands of both sides, considering that a payment from the issuing bank to the acquiring bank would in any case be necessary in order to compensate merchants⁵¹³.

From this perspective, MIFs are seen as balancing devices necessary in order to increase the value of the payment systems by shifting costs between issuers and acquirers and thus shifting charges between consumers and merchants⁵¹⁴.

Apart from being an integral part of any payment system, it is also submitted by part of the economic doctrine that MIFs would require a collective agreement for two reasons.

Firstly, the alternative of bilateral negotiations would inevitably impose high transaction costs with the consequential risk of destabilisation of the equilibrium price⁵¹⁵. Bilateral agreements may also have a detrimental impact on competition; in order to enter in the payment system, possible new members would be forced to

⁵¹² *Ibid.*, at p. 542.

⁵¹³ *Ibid.*, at p. 553, where it is claimed that “in four party payment mechanisms...a side payment between the cardholder and merchant, coupled with payment by each cardholder and merchant to their respective banks in amounts equal to respective bank costs but not to respective marginal utilities of cardholders and merchants, is theoretically sufficient to attain equilibrium. That in practice side payment between banks occur instead is strong evidence that higher transaction costs characterize side payments that take the form of price adjustments between the principals”.

⁵¹⁴ See R. Schmalensee, “Payment Systems and Interchange Fees”, Working Paper 8256, National Bureau of Economic Research, April 2001. According to Schmalensee, MIFs would not be harmful for consumers as they do not reduce the output like normal price fixing practices; on the contrary, MIFs “reversely maximise the output and welfare in order to maximise the system’s private value to its owners.” (p. 7). Document available at the following link: <http://www.nber.org/papers/w8256>(accessed on 20 July 2011).

⁵¹⁵ See W.F. Baxter, “Bank Interchange of Transactional Paper: Legal and economic Perspectives”, above., at p. 576.

bilaterally negotiate fees with thousands existing members with a potential restrictive effect on competition from the potential members⁵¹⁶.

Another possible risk arising from multilateral negotiations, would be the possibility of abuses of dominant position by strong members of the four-party payment system, which would use their position of dominance in order to superimpose fees on other members. This risk is to some extent related to the second main reason pro collective determination of MIFs, namely the incentive of issuing banks to exploit their “monopsony position” in order to demand higher than optimal interchange fees⁵¹⁷.

It has been also maintained by economists that merchants would not be in the position to contest individual issuer requests for excessively high fees, since they do not possess advanced electronic processing, and therefore are not capable of discriminating against specific card issuers without incurring a dramatic increment in transaction costs⁵¹⁸. Moreover, discrimination against card issuers would inevitably undermine the entire “utility of the systems to all participants together with the system’s viability in competition with other payment systems”⁵¹⁹.

MIFs have even been even theorised as potentially capable of promoting social welfare. Due to the existence of two joint parties within the framework of card payment systems, the argument would be that the use of MIFs represents a useful tool for the redistribution of costs capable of changing the prices charged against

⁵¹⁶ On this point see T. Ballell, “*Multilateral Agreements on Prices in Payment Systems: An Antitrust Approach*”, *World Competition* 25 (2), 2002, at p. 231.

⁵¹⁷ On this point see W.F. Baxter, “*Bank Interchange of Transactional Paper: Legal and economic Perspectives*”, above, at p. 576. As a result of higher prices charged to merchants, the issuing banks would be therefore in the position to capture all the excess of the higher fee bearing only a fraction of the loss in the overall system volume.

⁵¹⁸ *Ibid.*, at p. 576.

⁵¹⁹ *Ibid.*, at p. 586.

consumers and potentially of improving welfare⁵²⁰. This would be linked to the fact that within a payment system actions of an individual participant are capable of affecting the other participants and this effect is not considered when the individual participants take decisions⁵²¹.

Centralised interchange fees would therefore act as a potential catalyst element capable of neutralising a possible negative impact of negative impact of the individual actions of the participants in a payment system on the other members. MIFs could be therefore ultimately capable of maximising their benefit, passing it on to the society as a whole.

7.12 More Economic analysis: Arguments contra MIFs

The main argument against MIFs is that such agreements would constitute blatant price fixing practices highly detrimental for competition. MIFs are indeed usually jointly determined within payment systems by the four parties involved therein in the absence of any type of external scrutiny or forms of accountability to the community. It has been therefore submitted that MIFs restrain competition horizontally among issuers and acquirers of such systems⁵²².

The mechanism appears to be evident: since MIFs are set multilaterally, all card issuers participating in the payment system pay the same interchange fees. As a consequence, merchants' fees reflect the interchange fees multilaterally agreed; merchants are not in the position, as a matter of fact, to lower the interchange fees

⁵²⁰ On this point see the Reserve Bank of Australia, "*Interchange Fees- Reform of the Visa Debit Systems in Australia*", February 2005, at p. 15. The document is available at the following link: <http://www.rba.gov.au/payments-system/reforms/debit-card-systems/impact-stmt-apr06/recommend.html> (accessed on 20 July 2011).

⁵²¹ *Ibid.*, at p. 15.

⁵²² *Ibid.*, at p. 8.

threatening to pass on to another financial institution in order to supply the payment system's services⁵²³.

Another anticompetitive effect of MIFs would be the reduction (if not the elimination) of the non card-issuing acquirers capacity to compete with proprietary members of card payment systems that both issue cards and sign merchants.⁵²⁴ Since the so-called 'on-us' transactions (i.e. transactions in which the card-issuing bank and merchant-signing banks are the same) do not involve interchange fees, proprietary members processing 'on-us' transactions are in the position to reduce the merchant fees they charge. All this is deemed to restrain competition from the pure acquirers as they are obliged to maintain their merchant fees higher than the MIFs in order to make profits.

As a consequence, merchants tend not to negotiate with pure acquirers since they are in the position to receive a more profitable merchant fee from the proprietary members of a card payment system.

This scenario can easily lead card issuing banks to determine the level of MIFs so as to merely prevent merchant-signing banks from being in the position to compete. The result would see proprietary members of a card payment system as nothing more but a group of competitors who agreed to sell goods to each other, and MIFs would turn into a blatant horizontal price fixing kind of agreements.

In light of the aforementioned considerations, the determination of MIFs would not be therefore subject to normal competitive forces. As mentioned above, it

⁵²³ On this point see the Reserve Bank of Australia, "*Interchange Fees- Reform of the Eftpos and Visa Debit Systems in Australia*", above, at p. 19.

⁵²⁴ This argument was put forward by NaBanco against Visa in the US court of Appeal case *NaBanco v Visa USA*, 779 F.2d 592 (11th Cir. 1986), see p. 595-596. NaBanco was not a member of the Visa system as it was not eligible for federal deposit insurance. Nevertheless, NaBanco used to act as a processing agent for merchant-signing Visa members. Due to its position, NaBanco received the card-holder paper from merchants, exchanging the papers with the card-issuing banks. NaBanco also acted as agent of card-issuing Visa members (on this point see footnote 4 at p. 596 of the *NaBanco v Visa USA* judgment above).

has been claimed that on two-sided markets such as payment systems, collusive practices do not necessarily have a negative impact on competition due to the asymmetric platform competition characterising such markets. From this perspective, jointly determined MIFs would represent the right tool in order to achieve an optimal balance capable of satisfying the demands of both sides of the market.

It is opinion of this author that, with respect, this theory has limits: it starts from the assumption that the two market sides involved in card payment systems (i.e. card issuers and acquiring merchants) are perfectly competitive (which it is not necessarily true) and that MIFs are driven by “bank’s costs in serving each side of the market”⁵²⁵.

The rationale is therefore that merchants accept cards from consumers in order to lower processing costs, and that all merchants equally benefit from accepting cards⁵²⁶. This appears to be unrealistic as this theory arguably overestimates the merchant’s ability to resist increases in interchange fees,⁵²⁷ and underestimates the concrete risk that merchants would be willing to pass those fees on to clients⁵²⁸.

For these reasons, despite the idiosyncratic nature of two-sided markets that they belong to, MIFs can indeed be qualified as anticompetitive practices. Starting from this point, the next question to be faced is the one related to the indispensability of MIFs for the correct functioning of card payment systems.

As already mentioned, MIFs are considered by Visa as necessary vehicles to ensure the effectiveness of the cooperation between the various parties involved in

⁵²⁵ See W.F. Baxter, “Bank Interchange of Transactional Paper: Legal and economic Perspectives”, above., at p. 575.

⁵²⁶ See J. Wright, “The Determination of Optimal Interchange Fees in Payment Systems”, 52 J. INDUS.ECON. 1, 22 (2005). See also J.C. Rochet & J. Tirole, “Cooperation among Competitors: Some Economics of Payment Card Associations”, 33 RAND J. ECON. 549, 564 (2002).

⁵²⁷ See J.C. Rochet & J. Tirole, “Cooperation among Competitors: Some Economics of Payment Card Associations”, at p. 564.

⁵²⁸ See J. Wright, “The Determination of Optimal Interchange Fees in Payment Systems”, above, at pp. 23-24.

the card payment system, optimising the incentives in order to increase the network size.

This claim could arguably be rebutted on the basis of the argument that interchange fees rather than necessary components of card payment systems, are nothing but mechanisms to shift onto merchants (and indirectly onto consumers who pay by means other than payment cards) the costs of free advantages offered to cardholders⁵²⁹.

Most importantly, MIFs would not be indispensable for card payment schemes to function effectively, as in practice there are perfectly functional card payment schemes that operate without jointly determining interchange fees⁵³⁰. Visa itself, officially admitted that MIFS are not strictly necessary for the card payment scheme to work⁵³¹; their real function would rather be to enhance the operation scale and the competitive impact of the Visa scheme.

Without MIFs payment schemes would therefore offer a different ‘product’ to both classes of user in the four-party scheme; as a consequence, cardholders would get access to a smaller network of merchants and merchants to a smaller pool of cardholders⁵³². In this regard, MIFs would be only necessary in order to trigger the so-called network effects of the payment card systems.

⁵²⁹ See, for instance, Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 27.

⁵³⁰ For instance, the German ec-Karte scheme operates without MIFs. The ec-Karte scheme is defined by the Commission as a “four-party domestic debit card system whose functioning depends on the card chosen by the merchant. Ec-Karte cards can have different functions (e.g. guaranteed or unguaranteed); the merchant is in the position to determine which function to use paying fees to the issuing bank accordingly (in case a merchant opts for an unguaranteed transaction no fee is required)”. Another example of card payment scheme functioning without MIFs is represented by the Australian EFTPOS debit card scheme, in which fees are “bilaterally negotiated and go in the reverse direction (i.e. from issuing bank to acquiring bank)”. A further example is the Canadian Interac scheme, “a domestic four-party debit card system operating with MIF set at zero”. See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 28.

⁵³¹ See, for instance, Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 59.

⁵³² *Ibid.*

According to the Commission, the only provisions which seem “necessary for the functioning of a four-party card payment scheme appear to be (apart from technical arrangements on message formats), the obligation of the creditor bank to accept any payment validly processed within the system by a debtor bank and the prohibition on *ex post* pricing by one bank to another”⁵³³.

Furthermore, MIFs rather than promoting social welfare, have been considered by the European Authorities as mechanisms by virtue of which the costs of the advantage of using payment cards are shifted onto customers using other means of payments rather than payment cards⁵³⁴.

7.13 The Concrete effects of MIFs

Having considered the economic reasons pro and contra MIFs in the attempt to assess their real essence, the next step of the analysis seems inevitably to lead towards an empirical evaluation of the concrete effects of MIFs. On the basis of this empirical assessment, it will be possible in the following to endeavour to theorise possible alternatives or approaches for the regulation of interchange fees.

7.13.1 The Impact on Merchants

⁵³³ See the Commission Decision, *Dutch Banks*, OJ L 271/99, 21/10/1999, at paragraph 28. The claim here was that for the proper functioning of the payment scheme at issue, it is only necessary to set joint agreements on technical specifications and procedural aspects of transactions processing. Another essential element would be an a priori agreement on the level of charges (i.e. an agreement on whether to charge or not and, in the affirmative how much); such arrangement does not necessarily acquire the form of a MIF (recital 46). Also the recent “*Commission’s Interim Report on Payment Cards*”, (above, at p. 116) provides evidence that interchange fees are not intrinsic to the operation of card payment systems. The sector inquiry emphasises that several national systems operate without interchange fee mechanisms; as a consequence, the merchants fees result to be generally lower.

⁵³⁴ On this point see D.W. Carlton and A.S. Frankel, “*The Antitrust Economics of Credit Card Networks*”, *Antitrust Law Journal*, Vol. 63 (1995), p. 661. Document available at the following link: <http://www.nextera.com/content/publications.html> (accessed on 20 July 2011).

MIFs are collectively determined by the banks which are members of card payment systems (e.g. Visa or MasterCard) and firstly revert against merchants as they are imposed on them by the banks to which merchants process credit card transactions for payment⁵³⁵. Consequently, merchants deal with interchange fees as “higher costs of doing business”⁵³⁶.

Indeed, when a transaction is made at a point of sale with a credit or debit card, it is immediately submitted by the merchants to the acquirer. The card issuer bank at this point “anticipate funds to the acquirer on the consumer’s behalf, less the interchange fee”⁵³⁷.

As a result, merchants do not receive the full value of this transaction from the issuer banks; on the contrary, merchants receive the face value of the consumer transaction less the fees determined by the acquirer bank (the so-called merchant discount)⁵³⁸. The vast majority of the merchant discount is thus represented by the interchange fee paid by the merchant to the card issuer banks.

We have already seen that since the acquiring side of the payment card systems is considered to be fairly competitive, the interchange fee puts “a floor under the merchant discount”⁵³⁹. The natural consequence of this assertion would be that the variations of merchants discounts should tend to reflect the variations of MIFs.

⁵³⁵ See the *Statement of W. Stephen Cannon on Behalf of The Merchants Payments Coalition, Inc. before the United States Senate Committee on the Judiciary hearing on Credit Card interchange rates: Antitrust Issues?*, 19 July 2006. The document is available at the following link:

See also A.S. Frankel and A. L. Shampine, “*The Economic effects of Interchange Fees*”, 73 *Antitrust Law Journal* No.3 (2006), at p. 630.

⁵³⁶ See the *Statement of W. Stephen Cannon on Behalf of The Merchants Payments Coalition, Inc. before the United States Senate Committee on the Judiciary hearing on Credit Card interchange rates: Antitrust Issues?*, above, at p. 2.

⁵³⁷ See A.S. Frankel and A. L. Shampine, “*The Economic effects of Interchange Fees*”, above, at p. 630.

⁵³⁸ See A.S. Frankel and A. L. Shampine, “*The Economic effects of Interchange Fees*”, above, at p. 631.

⁵³⁹ See D. Evans and R. Schmalensee, “*Paying with Plastic: The Digital Revolution in Buying and Borrowing*”, Massachusetts Institute of Technology, 2005, at p. 276.

Economic studies appear indeed to prove that in case interchange fees decrease within a competitive system, merchant fees should decrease accordingly.⁵⁴⁰

7.13.2 *Effects on Consumers*

The effects of MIFs on merchants just analysed indeed revert also on to consumers, as ultimately consumers are the ones who provide the funds collected by the merchants and paid in form of interchange fees⁵⁴¹. Here the interesting point lies in the fact that, as it will be readily appreciated in the following, MIFs can also affect consumers using alternative forms of payments (e.g. cash or checks) rather than payment cards.

If we start from the assumption that payment card systems are perfectly competitive and no costs are associated with “pricing differently according to payment method”⁵⁴², it would be possible to theorise that interchange fees have no economic effects⁵⁴³. In such a scenario, MIFs would produce no harm or benefits being completely neutral (i.e. the net position of merchants, cash consumers, and credit card customers is not influenced by the variations of MIFs)⁵⁴⁴.

⁵⁴⁰ On this point see, *inter alia*, C.M. Abbey, “Interchange Fee Increase a Chance to Review Pricing”, AM. Banker, Mar. 3, 1998, at p. 20. In Australia, a survey study carried out by the Reserve bank of Australia emphasised the link between the decrease of interchange fees and the fall in the average merchant fees, outlining the competitiveness of the Australian payment card systems. The same did not happen in USA or in EU, where, in spite of a substantive reduction of acquirer costs due to the technological progress, Visa and MasterCard have recently raised interchange fees causing an increment of the average merchant discounts.

⁵⁴¹ On this point see A.S. Frankel and A. L. Shampine, “The Economic effects of Interchange Fees”, above, at p. 632.

⁵⁴² *Ibid.*

⁵⁴³ *Ibid.* Frankel and Shampine theorise a scenario in which an interchange fee for credit card transactions is determined at 5 percent of the sale amount and neither merchants nor issuers incur in any other payment costs. The assumption is that pricing is frictionless and that merchants charge credit card customers 5 percent more than cash customers, with issuers rebating 5 percent to those same credit customers. As a consequence, MIF would only circulate revenue from the cardholders to merchants and back again to cardholders.

⁵⁴⁴ On this point see D.W. Carlton and A.S. Frankel, “The Antitrust Economics of Credit Card Networks: Reply to Evans and Schmalensee Comment”, 63 ANTITRUST L.J. 903, 912 (1995). See also J. S. Gans and S. King, “The Neutrality of Interchange Fees in Payment Systems”, 3 TOPICS ECON. ANALYSIS 1 (2003).

The reality is regrettably different from this ideal and frictionless scenario: the effects of interchange fees on customers are strictly related to the level of their intensity; the more interchange fees become higher, the more is likely that merchants would pass the additional costs on to customers⁵⁴⁵. Here seems to lay the key to understanding the essence of the anti-consumer nature of MIFs: the higher Visa or MasterCard determine the interchange fees, the higher the volume of money received by their member banks.

In other words, it is in the interest of Visa and MasterCard to set high interchange fees; this increases the volume of money obtained by the members of the payment systems, money that can be used, for instance, in order to subsidise marketing efforts (e.g. reward point or airline miles) to promote the use of credit cards by consumers⁵⁴⁶. At this point the circle is closed: higher MIFs profitable for card issuers result in higher merchant fees that merchants inevitably pass on to consumers (the same consumers who ironically are invited to use credit cards by promotions sponsored through high interchange fees).

Even more ironically, consumers using cash or checks as payment methods suffer the effects of MIFs. The reason for this is to be found in the fact that MIFs, as we have seen above, are passed firstly onto merchants by the card issuers; merchants tend inevitably to react to this situation and, in order to recover the cost they incur, they increase the price of the goods they sell or the services they provide.

⁵⁴⁵ See D.W. Carlton and A.S. Frankel, “*The Antitrust Economics of Credit Card Networks: Reply to Evans and Scmalensee Comment*”, above, at p. 913.

⁵⁴⁶ See the *Statement of W. Stephen Cannon on Behalf of The Merchants Payments Coalition, Inc. before the United States Senate Committee on the Judiciary hearing on Credit Card interchange rates: Antitrust Issues?*, above, at p. 5.

7.13.3 *The impact on the Internal Market*

The recent Commission's *Interim Report on Payment Cards* emphasised the current presence of concrete elements indicating that the establishment of MIFs at international level may have as object and/or effect the creation of market entry barriers to competition between local and foreign banks⁵⁴⁷.

The Report highlights that the current EU market scenario sees local banks willing to set low interchange fees especially in relation to specific segments of the market, (e.g. food retailing or petrol stations), with very little choice: either they can set lower MIFs multilaterally in a local board, or they are forced to set them through a series of bilateral agreements between each issuer and each acquirer in a given country⁵⁴⁸. The research emphasised also that, under the network framework established by MasterCard and Visa, foreign banks are able to benefit from such preferential rates only in EU Member States where local banks “multilaterally determine merchant-specific rates”⁵⁴⁹.

In case MIFs are determined on the basis of a bundle of identical bilateral interchange fees arrangements, foreign banks end up paying higher fallback rates⁵⁵⁰. Furthermore, a comparison between the national interchange fees level set by Visa and MasterCard across the internal market appears to suggest that the high level of some merchants' fees may result from the exercise of market powers by acquirers⁵⁵¹.

Doubts seem also to arise in relation to the inter-system competition between MasterCard and Visa which appears to act as a sort of “disciplining market force on members of the card payment systems determining the level of interchange fees

⁵⁴⁷ See the “*Commission Interim Report on Payment Cards*”, above, at p. 116.

⁵⁴⁸ See the “*Commission Interim Report on Payment Cards*”, above, at p. 116.

⁵⁴⁹ *Ibid.*

⁵⁵⁰ *Ibid.*

⁵⁵¹ *Ibid.*

within these networks”⁵⁵². As a matter of fact, the average MasterCard interchange fees for cross-border transactions increased from 2002 despite a reduction of the correspondent Visa fees⁵⁵³.

This appears to suggest that inter-system competition is somehow affected and restrained by MIFs. In other words, market forces might not be an effective deterrent mechanism for card payment systems characterised by a high level of MIFs⁵⁵⁴.

Finally, in relation to possible barriers in terms of market entry, the Report submits that in countries where an inter-bank association acquires transactions from an international card payment network, local banks members of this inter-bank association are in the position to offer lower fees to the association. As a result, inter-bank associations are in the position to prevent new competitors from entering into the market⁵⁵⁵.

Overall, the economic theories which revolve around MIFs are conflicting and do not appear to provide an answer to the main questions this thesis endeavours to answer: are MIFs really necessary? Is it possible to identify possible alternatives? Most of all, how should competition law approach them? In order to answer these questions, it is first necessary to consider the so called ‘No-Discrimination Rules’.

7.14 No-Discrimination Rules

⁵⁵² According to the Report, the evolution of Visa and MasterCard cross-border interchange fees between 2001 and 2004 raise some concerns relating to the fact that the MasterCard cross border interchange fees increased since 2002 despite Visa’s weighted average interchange fees for cross-border transactions decreased from that year onwards.

⁵⁵³ See the “*Commission’s Interim Report on Payment Cards*”, above, at p. 116.

⁵⁵⁴ This claim, according to the Report, seems to have a solid validity especially in relation to MIFs for cross-border transactions (See p.116).

⁵⁵⁵ See the “*Commission’s Interim Report on Payment Cards*”, above, at p. 116.

Card payment systems generally use the so called no-discrimination rules in conjunction with MIFs. No-discrimination rules usually assume the form of the so-called “honour all cards rules”, forcing merchants to accept all the cards issued by the members of a specific card payment system (e.g. Visa). In addition, no-discrimination rules prevent merchants from surcharging cardholders using their payment cards, and from offering discounts or incentives to consumers for using alternative means of payment.

It is rather easy to understand the possible negative impact on competition of no-discrimination rules; the main negative consequences of such rules are represented by the deprivation of the merchants’ freedom to modify prices according to costs, in conjunction with the impossibility for merchants to provide consumers with incentives for alternative payment methods. No-discrimination rules tend in this way to exacerbate the fact that the actual costs of different payment systems are in practice hidden from consumers. Merchants are prevented, as a matter of fact, from recommending to customers less costly payment methods⁵⁵⁶.

Furthermore, “honour all cards rules” practically leave no alternatives to merchants but to accept all the branded cards of a specific network, consequently putting card issuers of card payment networks in a strong bargaining position eliminating their need to compete for merchant acceptance.

In order to counter-balance this situation merchants are invariably forced to pass on their costs to consumers increasing the costs of goods and services they provide. As a consequence, consumers paying with payment cards end up paying

⁵⁵⁶ On this point see D.A. Balto, *“The Problem of Interchange Fees: Costs Without Benefits?”*, [2000] E.C.L.R., Issue 4, at p. 224. See also, S. Chakravorti & S. Emmons, *“Who Pays for Credit Cards”*, Emerging Payments Occasional Paper Series, EPS-2001-1, Federal Reserve Bank of Chicago, 2001, at p. 3.

more for goods and services, and even consumers using alternative payment methods are affected as they end up subsidizing the costs of card payment systems.

All this inevitably leads to severe restrictions on both level of inter-system and intra-system competition⁵⁵⁷.

7.14.1 No-discrimination rules and EU Competition Law

In order to be considered lawful under EU law, no-discrimination rules need to fulfil the requirements of Art. 101; this does not seem the case, as no-discriminatory rules are indeed agreements capable of restricting and distorting competition.

No-discriminatory rules remarkably reduce the bargaining position of merchants, who are obliged to accept all the cards issued within a card-payment network without being capable at the same time of surcharging cardholders or offering them incentives for alternative payment systems.

The next step for the analysis of no-discriminatory rules is therefore to assess whether such rules would be in the position to benefit from an exemption under Art. 101(3).

No-discriminatory rules have indeed been theorised as beneficial and essential for the functioning of card-payment systems, as they would reduce the transactions costs of payments together with risks associated to cash/cheques handling⁵⁵⁸ (fraud or theft). In addition, no-discriminatory rules would have positive effects also vis-à-vis consumers who, thanks to them, would be in the position to

⁵⁵⁷ See M. Negenman, “*EU Antitrust Law (Article 85 and 86) and Their Potential Impact on the Banking Sector of Czech*”, 1988. Document available at the following link: http://europa.eu.int/comm/competition/speeches/text/sp1998_016_en.html (accessed on 20 July 2011).

⁵⁵⁸ See S. Chakravorti & S. Emmons, “*Who Pays for Credit Cards*”, above, at p.10-14.

make purchases in a safer and more efficient way, without the need to plan “how they intend to pay”,⁵⁵⁹.

As a consequence, no-discrimination rules would increase the sales and are seen as the price merchants have to pay in return for their beneficial effects⁵⁶⁰, i.e., a sort of compensation vehicles for the costs and risks incurred by acquirers and issuers in processing card payment transactions. A scenario without no-discrimination rules would see merchants in an unfairly unbalanced advantageous position as they would be in the position to surcharge consumers in order to recover their costs without paying anything in return for the benefit of belonging to a card-payment network.

This would result in consumers bearing all the costs for card transactions with the risk of causing a sort of “death spiral” for card networks, as fewer cardholders would mean fewer merchants, with the subsequent elimination of the benefits of card-payment systems⁵⁶¹.

7.14.2 The judicial approach to no-discrimination rules

The debate relating to no-discrimination rules started in the U.S., where they were first the object of antitrust scrutiny which lead to inconsistent results⁵⁶². The current U.S. scenario sees the legislative intervention of several States allowing no-

⁵⁵⁹ See D. Cruickshank “*Competition in UK Banking: A Report to the Chancellor of the Exchequer*”, March 2000, at paragraphs 3.14- 3.16, p 51-65.

⁵⁶⁰ See MasterCard International Incorporated, “*Submission to Reserve Bank of Australia*”, Sydney, 2001, 140088 VI, p. 35-38. Document available at the following link: http://www.mastercard.com/au/rba/MC_submission_June2001.pdf. (accessed on 20 July 2011).

⁵⁶¹ On this point see A.S. Frankel and A. L. Shampine, “*The Economic effects of Interchange Fees*”, above, at p. 669.

⁵⁶² A no-discriminatory rule imposing an obligation of no-surcharge on merchants was upheld by the court in *Southtrust Corp. v PLUS Sys., Inc.*, 913 F. Supp. 1571, 1522 (N.D. Ala 1995). *In re Arbitration between First Texas Sav. Ass’n & Financial Interchange Inc.*, 55 Antitrust & Trade Reg. Rep. (BNA) 340, 350 (August 25, 1988), ATM interchange fees were held to be lawful only insofar the network rules provide a general prohibition of no-discriminatory rules preventing merchants from surcharges.

discrimination rules and consequently introducing a general prohibition on surcharges by merchants⁵⁶³. Other States have introduced a general ban on no-discriminatory rules preventing merchants from surcharging consumers, or they do not provide any form of legislative intervention to this regard⁵⁶⁴.

In Europe, no-discrimination rules have been in the past the object of antitrust analysis by the Commission. In 2000, the results of a survey commissioned by the Commission on the effects of the abolition of no-discrimination rules in Sweden and the Netherlands were publicly released⁵⁶⁵. The outcome of the research has showed that in absence of no-discrimination rules, only a minimum percentage of merchants⁵⁶⁶ decided to recover costs by surcharging customers. The reason for this is to be found in the risk for merchants to trigger a negative reaction from consumers and as a consequence to lose clients. No-discrimination rules appear, thus, to have a limited impact in practice on competition within the inter-system market⁵⁶⁷.

Another interesting finding of the above survey is that the abolition of no-discrimination rules did not have any impact on merchant fees⁵⁶⁸. This appears to suggest that, in practice, no-discrimination rules do not affect intra-system market

⁵⁶³ The States adopting such regulatory approach are California, Colorado, Connecticut, Florida, Kansas, Maine, Massachusetts, New York, Oklahoma and Texas.

⁵⁶⁴ See S. Chakravorti & Shah, “*Underlying Incentives in Credit Card Networks*” Antitrust Bulletin, Spring 2003, pp. 53-75 Spring 2003

⁵⁶⁵ See IMA Market Development AB (2000), “*Study Regarding the Effects of the Abolition of the Non-discrimination Rule in Sweden for European Commission Competition Directorate General-Final Report*”, 02/29/2000; Available at: <http://europa.eu.int/comm/competition/antitrust/cases/29373/studies/> (accessed on 20 July 2011). See also ITM Research, “*The Abolition of the No-discrimination Rule, Project number: R231*”, Amsterdam, March 2000. Available at: <http://europa.eu.int/comm/competition/antitrust/cases/29373/studies/> (accessed on 20 July 2011).

⁵⁶⁶ Approximately 5 percent in Sweden and 10 percent in Holland. See IMA Market Development AB (2000), “*Study Regarding the Effects of the Abolition of the Non-discrimination Rule in Sweden for European Commission Competition Directorate General-Final Report*”, above.

⁵⁶⁷ See IMA Market Development AB (2000), “*Study Regarding the Effects of the Abolition of the Non-discrimination Rule in Sweden for European Commission Competition Directorate General-Final Report*”, above.

⁵⁶⁸ See IMA Market Development AB (2000), “*Study Regarding the Effects of the Abolition of the Non-discrimination Rule in Sweden for European Commission Competition Directorate General-Final Report*”, above.

competition, as their absence did not trigger a higher level of competition between acquirer banks with a subsequent decrease of merchants' fees.

Finally, the surveys indicate that even costs transparency for consumers did not improve after the abolishment of no-discrimination rules; the few merchants who decided to surcharge customers, as a matter of fact, did not provide clients with relative information, and as a result charged customers more than the merchants' fees (this happened specifically in the transport sector, e.g. taxi and travel agency)⁵⁶⁹.

As a consequence of the empirical evidence gathered, the Commission held in its 2001 *Visa International Decision*⁵⁷⁰ that no-discrimination rules do not have an appreciable effect on competition within the meaning of art. 101(1)⁵⁷¹.

Contrary to this approach, the relevant Authorities in the UK have abolished no-discrimination rules in 1990 with successful results. It needs to be specified that in contrast with the regulatory approaches of Sweden and Holland, the UK abolishment was accompanied by crucial ancillary measures. These measures in first place imposed on merchants the obligation to declare in advance possible charges for different types of payment.

Secondly, they established a cap on merchants' fees to be surcharged to customers, which cannot exceed the effective transaction costs faced by merchants.

As a result, in UK the negotiating position of merchants improved remarkably in the last seventeen years together with the number of customers using card payment systems⁵⁷².

⁵⁶⁹“Study Regarding the Effects of the Abolition of the Non-discrimination Rule in Sweden for European Commission Competition Directorate General-Final Report”, above.

⁵⁷⁰ Commission Decision, *Visa International*, Case COMP/29.373, OJ L 293, 10/11/2001, p.24-41

⁵⁷¹ *Ibid.*, at paragraphs 54-58. Art. 81(1) prohibits agreements having as their object or effect the prevention, restriction or distortion of competition within the internal market. The concept of ‘appreciable/noticeable effect’ on competition was introduced by the ECJ in Case C-5/69 *Volk*, [1969] ECR 295. Consequently, the European Commission released the “De Minimis Notice” in 1970 in order to clarify the above concept. After subsequent replacement, the point of reference is currently represented by the 2001 “De Minimis Notice” (OJ C 368, 22/12/2001).

The importance of the adoption of such ancillary measures accompanying the abolishment of no-discrimination rules appears to be confirmed by the Australian regulatory approach. Just like the UK authorities, the Reserve Bank of Australia has imposed disclosure requirements on merchants and caps on surcharge fees to the general satisfaction of both merchants and consumers.

It appears that the Commission did not take into account these elements in assessing the effects of no-discrimination rules. The Swedish and Dutch approaches do not seem, with respect, to be representative of the real effects on competition of no-discrimination rules. The consequences of the abolition of no-discrimination rules alone has a limited value; in order assess the real effects on competition and at the same time to ensure a high level of consumer protection, the introduction of ancillary obligations such as disclosure requirements and limitation on surcharge fees appear to be necessary. From this perspective, the UK and Australian approaches are arguably more indicative of the real impact of no-discrimination rules on the market, and seem interestingly to suggest the possibility of disentangling no-discrimination rules from MIFs.

Thus far, the Commission has not considered this option. The starting point of its analysis is that no-discrimination rules do not have an appreciable effect on competition. Nevertheless, as we have just seen, the platform for the rationale of the Commission's assessment of no-discrimination rules is represented by empirical evidence gathered in relation to two markets (the Swedish and Dutch card payment markets) in which the regulatory intervention was confined to the elimination of no-discrimination rules without considering possible ancillary issues relating to consumer protection.

⁵⁷² On this point see Faull & Nikpay, *"The EC Law of Competition"* OUP, above, p. 650.

If, on the contrary, the starting point of the analysis of the Commission was the consideration of the UK and Australian markets (i.e. the acknowledgment of the negative effects on competition of no-discrimination rules), the next question to address would be that of the relationship between no-discrimination rules and MIFs. In other words, are no-discrimination rules essential for the functioning of MIFs? Theoretically, the answer is no, they are not. No-discrimination rules impose ancillary restraints on merchants, limiting their bargaining position and their possibility to offer incentives to consumers in order to choosing between different payment methods.

From this perspective, no-discrimination rules appear only to render more effective MIFs and card payment networks in the sense that they oblige merchants to accept all cards issued by the members of a specific network, depriving them the possibility to suggest alternatives to clients. These observations are arguably endorsed by empirical evidence suggesting the possibility to disentangle no-discrimination rules from MIFs. If we refer, for instance, to the surveys relating to the Swedish and Dutch markets, these examples are indeed emblematic as the abolition of no-discrimination rules was not accompanied by the abolition of MIFs.

These considerations are of paramount importance and will carefully be weighed in the following in order to identify possible alternative regulatory approaches to MIFs.

7.15 Current state of play and possible alternative scenarios

Since MIFs can be defined as forms of horizontal co-operation between banking undertakings, they have been in the past considered detrimental for competition

between banks providing services to cardholders and to merchants, by courts and regulators both in Europe and in the United States.

7.15.1 The European position

In Europe, as established above, Visa's and MasterCard's MIFs have been in recent years object of scrutiny by the Commission. In the former case, the Commission allowed only after Visa committed itself to "(i) determine the level of the interchange fees on the basis of objective costs incurred by the issuers in providing concrete services to merchants and (ii) allow member banks to disclose the MIFs to merchants"⁵⁷³.

Abiding by the same rationale of the Commission's Decision in Visa, the UK Office of Fair Trading, the Spanish Tribunal for the Defence of Competition and the Italian Central Bank, after having concluded that MIFs indeed represent an infringement of competition law, decided to allow them only insofar as they are determined on the basis of the effective costs incurred by issuing banks for processing card-related transactions⁵⁷⁴.

With its recent decision in MasterCard, the Commission reiterated the approach adopted in the Visa Decision, finding the MasterCard MIF in breach of EU competition law as it was set on an artificially inflated level.

The European position seems thus clear: despite a general and undisputed acknowledgment of the potential detrimental effect of MIFs on competition, MIFs are nevertheless allowed if they reflect effective costs incurred by the issuing banks.

⁵⁷³ See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph. 2 (1b).

⁵⁷⁴ See the "*Commission's Interim Report on Payment Cards*", above, at p. 116.

Since an essential feature of such systems is that the card issuing banks provide specific services for the benefit of the merchants via the acquiring banks, MIFs are an effective and necessary vehicle for costs recovery by the issuing banks (given the difficulties of measuring the average marginal utility of a card payment to each category of user belonging to the system⁵⁷⁵).

The element of the network externalities seems to play a crucial role in both decisions: as analysed above, any four-party card payment scheme is characterised by network effects, by virtue of which the more merchants are present within the system, the greater the utility to cardholders and vice versa⁵⁷⁶.

7.15.2 *The USA position*

In the US, the current regulatory approach relating to MIFs arises from the case law, with the *NaBanco*⁵⁷⁷ judgment as the main point of reference. In *NaBanco*, the court held that despite their potential anticompetitive nature, MIFs could be allowed for several following reasons. In the first place, interchange fees were intended as ‘transfer payments’ necessary in order to balance in an optimal way the costs and benefits between the merchants and card-issuing banks within a card payment scheme⁵⁷⁸. Secondly, the impact of MIFs on competition was considered minimal, as

⁵⁷⁵ See Commission Decision, *Visa International-Multilateral Interchange Fee*, above,

⁵⁷⁶ The Commission recognises the network effect of card payment systems as an essential pre-requisite for an exemption under Art. 101(3). See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, at paragraph 83.

⁵⁷⁷ See *NaBanco v Visa USA*, above.

⁵⁷⁸ See *NaBanco v Visa USA*, above, at 479. This line of reasoning clearly influenced the Commission and the European stance on MIFs. For an economic analysis of the rationale laying beyond the decision see W.F. Baxer, “Bank Interchange of transactional Paper: Legal Perspectives”, 26 Journal of Law and Economics 41 (1983).

the court identified the relevant market with all the possible payment systems (that is to say that, in case MIFs are increased to an anticompetitive level, merchants can still rely on a variety of alternative payment systems).

Finally, the court found that it was not possible to identify less restrictive alternatives to MIFs, as at that time card issuing banks were prevented from charging fees directly from customers. In particular, individual bilateral negotiations between merchants and card issuing banks were ruled out as an alternative to MIFs as impractical due to the large number of members characterising the Visa system⁵⁷⁹ (at that time there were around 15 thousand members in US).

In the US, the *NaBanco* judgment still nowadays remains the point of reference in relation to MIFs. Nevertheless, in the subsequent *First Texas* litigation⁵⁸⁰, the antitrust arbitrator came very close to declaring the illegality of MIFs holding that “where the benefits of a competitive market can be obtained without a substantial impairment of efficiency, the restraint cannot be viewed as reasonable.”⁵⁸¹ The line of reasoning here was that collectively determined MIFs may be necessary and excusable at an early stage of a payment system, but their justification becomes difficult once a payment card network becomes dominant in the market. On the basis of this sort of ‘two tiers approach’, MIFs used by well-established and ‘dominant’ systems such as MasterCard and Visa would allegedly incur into sever difficulties in order to pass antitrust assessments.

Further, if compared to the Commission decisions in *Visa* and *MasterCard* considered above, one may claim that the US and EU positions in reference to MIFs

⁵⁷⁹ In the US at that time the Visa system comprised of circa 15 thousand members.

⁵⁸⁰ *In re Arbitration between First Texas Sav. Ass’n & Financial Interchange Inc.*, 55 Antitrust & Trade Reg. Rep. (BNA) 340, 350 (August 25, 1988).

⁵⁸¹ *Ibid.*, at paragraph n.11. For an overview of the US scenario see D.Balto, “*The Problem of Interchange Fees: Costs without Benefits?*”, 2000, E.C.L.R., p.215.

differ quite considerably. Despite the fact that the *NaBanco* judgment did question the compatibility of MIFs with *anti-trust* law, their actual impact on competition was considered minimal due to the alternatives in terms of different payment systems available in the market.

Contrary to the US approach, the Commission did not consider this element at all. The considerations related to the relevant market and alternative payment methods enshrined in *NaBanco* appear, with respect, somehow disingenuous. Different payment systems are indeed available in the market, nevertheless it appears also undeniable that rather than an alternative, card payments have nowadays assumed their own unique dimension.

This is especially evident if the merchants position is considered. If merchants decided to exit from a card payment system due to an intolerable level of MIFs, the only alternatives possible would be to make customers pay by cash and/or cheque; either of these two alternatives do not seem to represent a viable option.

It has been previously established that merchants represent the ultimate party of the *sui generis* two sided market system arising from card payment systems: the position of the merchants, in conjunction with the reaction of the ultimate users, i.e. customers, seems therefore to play a paramount role in order to determine the relevant market. Consequently, in order to determine whether card payment systems represent, *per se*, the relevant market or concur with other payments methods, the question that one shall ask is the following: if deprived of card payment options, how would customers react? Would they be inclined to pay by cash or cheque instead? The answer to these questions appears to differ considerably if compared to other 'products' and markets. Let us consider by way of example the market for computers: it appears clear that if deprived of the opportunity to buy computers

customers would not buy radios instead, the main consequence of this scenario being that the market for computers is to be considered as a distinguished market.

The scenario is radically different when it comes to payment systems, since we are dealing with a service, rather than a 'product'. Furthermore, the fact that we deal not only just with a service, rather with a service arguably essential complicates matters even further. If deprived of the opportunity to pay with cards, it appears indeed reasonable to claim that customers would use other payment systems instead, as they would need to pay in a way or another for products/services they purchase. Hence, *prima facie* it is possible to claim with reasonable certainty that the relevant market should not be confined to card payment systems, but should comprise all different payment methods available to end users.

Nevertheless, if the considerations stopped here, the outcome would be rather devious and misleading. The reason for this is that we are dealing with an essential service, rather than a product. Due to its essential nature and its consequent high level of interchangeability, this service needs to be (and will be) explicated in a way or another. Yet, the aforementioned considerations do not appear to be conclusive as to the determination of the relevant market, and the answer to the above question, should, with respect, be re-considered in a different way focusing on the willingness and the reaction of customers.

Far from being based on objective considerations, this test would attract undoubtedly criticism, but appear to be the only valid alternative to re-consider the matter object of our analysis. The question would thus be re-formulated in the following way: in absence of card payments options, would customers be satisfied and willing to pay in an alternative way? The answer to this question would be clearly negative, as card payment systems represent nowadays the foremost method

of money transmission in the modern economy⁵⁸². On the basis of such considerations, it seems reasonable to claim that card payment systems represent the relevant market within which the antitrust issues arising from MIFs should be assessed.

Contrary to the *NaBanco* judgment, the Commission in both *Visa* and *MasterCard* considered the compatibility of MIFs with EU competition law within the framework of card payment systems and, as previously established, reached a rather different conclusion. In both decisions, MIFs were considered as the object of serious antitrust concerns and allowed only if not artificially inflated. Here seems to lie a common point of contact between the US and EU approach; MIFs are considered inherently necessary for the functioning of card payment systems and possible alternatives are not considered as viable options.

This sets the scene for the next level of the analysis which will be now devoted to the identification of possible alternatives to MIFs.

7.16 Possible alternatives to MIFs

Economists and lawyers have theorised several alternatives to MIFs. The first alternative is represented by bilateral agreements. Another alternative has been identified with a system of par collection setting the level of the interchange fees at zero. In the following, these will be considered below in turn in order to assess their validity.

7.16.1 Bilateral agreements

⁵⁸² By the same token, if we were to consider the market for electricity and determine the relevant market solely on the basis of the concept of interchangeability the results might be equally misleading. If the question to be answered was what consumers would do in absence of electricity, would they use candles instead? The answer to that question would probably be positive. This would lead to the rather misleading identification of the market for candles and electricity as the relevant product market.

The first natural alternative to multilaterally set interchange fees is represented by a decentralised interchange fees system based on bilateral negotiations. Under such scenario, each card issuer is supposed to declare in advance the fee it will charge to the acquirers in processing their cardholders' transactions. Alternatively, each pair of banks part of the card payment scheme (i.e. issuers and acquirers) need to bilaterally determine the level of the fees to be paid in relation to the card payment transactions occurring between them⁵⁸³.

Bilateral negotiations of interchange fees have been tamed as “a market-based alternative to centrally set interchange fees”⁵⁸⁴. The main criticism for bilaterally negotiated fees lies in the inefficiencies that such schemes would cause. Thousands of banks that are members of a card payment system would have to enter into a virtually endless chain of bilateral negotiations in order for the system to work⁵⁸⁵. Nevertheless, in practice there are ways to avoid and to mitigate inefficiencies; one system could be implemented through a series of direct negotiations between a small number of banks and large members of the card payment system.

For instance, in Europe the top ten acquirers account for approximately 80 per cent of all MasterCard and Visa card transactions⁵⁸⁶, whereas the top ten issuers

⁵⁸³ For a detailed analysis of bilateral fees agreements, see J. Small & J. Wright, “*The Bilateral Negotiation of Interchange Fees in Payment Systems*”, (January 2002). Document available at the following link: http://profile.nus.edu.sg/fass/ecsjkdw/setting_interchange_2002.pdf (accessed on 20 July 2011).

⁵⁸⁴ *Ibid.*, at p.3. As mentioned above, bilateral interchange fees have been used in the Australian online EFTPOS debit card system. According to the UK Office of Fair Trading, they have been also used by MasterCard and Visa in Sweden.

⁵⁸⁵ This criticism lead the Commission and the American courts to disregard bilateral negotiated fees as a valid alternative to MIFs. See the Commission Decision *Visa*, above, and the *NaBanco* US judgment above.

⁵⁸⁶ See the “*Commission’s Interim Report on Payment Cards*”, above, at p. 88.

deal with approximately 78 per cent of the charge volume⁵⁸⁷. This means that individual banks not prepared to negotiate with many other banks would need only to negotiate a single correspondent services contract⁵⁸⁸.

Another argument of censure for bilateral negotiations is related to the fact that through bilateral negotiations each issuer would have an enormous power on over each acquirer. This concern derives from the fact that within the MasterCard and Visa systems, a merchant accepting a branded card MasterCard or Visa, is forced to accept all the MasterCard/Visa cards issued by all MasterCard/Visa members⁵⁸⁹ (this is the so-called honour-all-cards rule). By virtue of this rule, it has been noted that the power of the issuers (even the smallest ones) over the acquirer and its merchants is enormous (a very small issuer, for instance, could require high fees for signing a contract with acquirers)⁵⁹⁰.

Honour-all-cards rules would therefore put the acquirers in a disadvantageous position in respect to negotiations with other issuing banks, as their merchants are obliged to accept the other issuing banks' cards, leaving the acquirers without any guarantee of payment by the card issuers.

This criticism relating bilateral negotiations nevertheless reverts back to the MIFs. If it is true that a system of bilateral negotiations would put every single issuer in a very powerful situation, it is also true that this power is even stronger if exercised collectively by all card issuers as in the case of multilaterally determined

⁵⁸⁷ *Ibid.* For the USA market, see A.S. Frankel and A. L. Shampine, "The Economic effects of Interchange Fees", above, at p. 640.

⁵⁸⁸ For an economic analysis on this point see A.S. Frankel and A. L. Shampine, "The Economic effects of Interchange Fees", above, at p. 640.

⁵⁸⁹ On this point see A.S. Frankel and A. L. Shampine, "The Economic effects of Interchange Fees", above, at p. 640. Both Visa and MasterCard Systems adopted this rule by virtue of which when a merchant accept a MasterCard/Visa card, he is obliged to accept all the MasterCard/Visa cards issued by other members of the systems.

⁵⁹⁰ On this point see A.S. Frankel and A. L. Shampine, "The Economic effects of Interchange Fees", above, at p. 640.

interchange fees. In such a system, the market power is transferred from single issuers to the entire network⁵⁹¹.

It is submitted by the author that bilateral negotiations might indeed represent an alternative to MIFs. The hold-up problem raised by the excessive power conferred on single issuers could be faced by regulatory means aiming to prohibit honour-all-cards rules obliging merchants to accept all cards issued by the members of a specific card payment scheme. This would arguably counter fight the bargaining power of the issuer banks, enhancing at the same time the competition within the system.

7.16.2 Par collection systems

The other main alternative to MIFs is represented by par collections system in which MIFs are set at zero⁵⁹², (i.e. MIFs practically do not exist). The main criticism to such systems lies with the fact that, in the absence of MIFs, card issuers and merchants would be compelled to find alternative ways to recover their costs within the card-payment system. This could allegedly lead to an increment of consumers' costs for the use of credit/debit cards.

Yet again, this criticism appears to revert against the current MIFs regime. We have seen that, in practice, consumers are destined anyway to bear the cost of MIFs without being even aware of their existence. In the absence of MIFs, the costs incurred by the members of a payment-card system would be charged upfront against

⁵⁹¹ See J.C. Rochet & J. Tirole, "Cooperation Among Competitors: Some Economics of Payment Card Associations", 33 RAND J. ECON. 549 (2002). On this point see also G. Guthrie & J. Wright, "Competing Payment Schemes", University of Auckland, Working Paper No. 245, 2003. See also A.S. Frankel and A. L. Shampine, "The Economic effects of Interchange Fees", above, at p. 640.

⁵⁹² For a detailed economic analysis of this scenario see D.S. Evans and R. Schmalensee, "The economics of Interchange fees and their Regulation", 2005, at p. 84.

customers. This scenario may in practice lead to a more competitive behaviour of the banks offering card payment services, which inevitably would be forced to offer discounts or competitive cost rates in order to attract new clients.

One of the main concerns relating to an environment deprived of MIFs would be related to the position of the merchants. In the first place, it is highly likely that merchants would be the bearers of the possible discounts or promotions provided by issuing banks to cardholders.

Secondly, for a 'no-interchange fees' system to function properly, merchants must be in the position to flag precise price signals to consumers. In order to do so, no network rule preventing these signals should be allowed (e.g. yet again there should be a prohibition of the so-called non-discrimination rules preventing different price treatments for consumers using different card-brands)⁵⁹³.

The ultimate crucial point to be assessed is related to transactions costs; MIFs have been theorised as necessary vehicles for the recovery of transaction costs within a card payment system. If it is then possible to maintain that a card payment system comprising a low numbers of members could be in the position to recover transaction costs without the need to set MIFs, the same cannot be claimed in reference to card payment systems established on a large scale. It is indeed when the system develops and the number of members increases exponentially that the moment when MIFs are considered by the doctrine as the ideal instrument of cost recovery arises⁵⁹⁴. Nevertheless, as just established, a valid alternative at that stage might be the use of bilateral negotiations. This scenario arguably does not seem to have a negative impact on the network effects proper of four party schemes, as banks would still be

⁵⁹³ On this point see D.A. Balto, "*The Problem of Interchange Fees: Costs Without Benefits?*", [2000] E.C.L.R., Issue 4, at p. 223.

⁵⁹⁴ See D.A. Balto, "*The Problem of Interchange Fees: Costs Without Benefits?*", [2000] E.C.L.R., Issue 4, at p. 223.

in the position to attract new merchants, merchants new customers, all this triggering the enhancement of the system without the need for MIFs.

7.17 The Way Forward: Possible Regulatory Approaches to MIFs

Having analysed the controversial antitrust issues stemming out the use of MIFs by card payment systems, it is now possible to proceed to the formulation of possible regulatory frameworks for multilaterally agreed fees.

Two main regulatory streams will be considered: the starting point of the first possible regulatory approach is the acknowledgement of the necessity of MIFs, or at least the lack of valid alternatives. The second main approach is, on the contrary, based on the introduction of a general prohibition of MIFs. Both are considered in turn below.

7.17.1 A regulatory approach acknowledging the legality of MIFs

A regulatory approach allowing the members of card-payment systems to collectively determine interchange fees reflects the current antitrust position in Europe and US. As analysed above, the ECJ and the Commission in Europe, as well as the American courts in US have allowed in the past, and currently still allow, the use of MIFs. At the same time, emphasis in both legal systems was put on the potential anticompetitive effects of jointly set interchange fees.

If the starting point is the acknowledgement of the necessity of MIFs (or the lack of suitable alternatives), yet a regulatory intervention appears to be necessary in

order to mitigate possible anticompetitive effects vis-à-vis consumers. This regulatory intervention can assume various forms.

7.17.2 Full disclosure and strict regulation of costs

One possible way to regulate interchange fees can be represented by the imposition of a full disclosure obligation on the members of a card payment system in relation to the nature of the costs covered and the rationale of the interchange fees⁵⁹⁵. Such approach is based on a high degree of integration between the economic and legal analyses of MIFs, and on the recognition of the economics of two-sided markets as four party card payment systems.

As emphasised above, the starting point of the economic analysis of two-sided markets is that each side of the market (i.e card-issuers-acquirers and merchants-customers) is not in the position to recover its processing costs in a competitive situation⁵⁹⁶.

Furthermore, the possibility for MIFs to trigger the so called ‘network effects’ necessary for the expansion and the existence of the card-payment system should be taken into account, in conjunction with the elasticities of the demand on both sides of the market. In this regard,, MIFs should not be interpreted as strictly

⁵⁹⁵ As analysed above, this approach has been adopted by the Commission in the Visa Decision above, where the Commission decided to grant an exemption under Art. 81(3) (now 101(3) , insofar Visa committed itself to “(i) determine the level of the interchange fees on the basis of objective costs incurred by the issuers in providing concrete services to merchants; and (ii) allow member banks to disclose the MIFs to merchants”. See Commission Decision, *Visa International-Multilateral Interchange Fee*, above, paragraph. 2(1b). In USA some ATM networks have adopted the same approach. In UK, the D. Cruickshank Report suggested the imposition of full disclosure of interchange fees to merchants and consumers, as well as the necessity for the rationale of MIFs to be based on effective and legitimate costs. See D. Cruickshank “*Competition in UK Banking: A Report to the Chancellor of the Exchequer*”, March 2000, at 3.199, 3.213.

⁵⁹⁶ On this point see S. Semerato, “*Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty*”, above, at p. 988.

designed to balance the costs of the two markets, as the fluctuations in terms of demand on both sides of the market are impossible to foresee⁵⁹⁷.

If antitrust rules are applied to the market of card-payment systems in conjunction with the above economic analysis, the result would lead legislators or regulatory bodies to allow the existence of collectively determined fees, regulating only the possible negative side-effects on competition. These side effects comprise possible abuses due to the lack of transparency relating to the real essence of MIFs which can, for instance be set at a very high level for no practical reason other than to increase profits. A requirement of transparency through public disclosure of the rationale of the level of MIFs seems a good regulatory means, but it is only the first step. Imposing an obligation of disclosure on card issuers appears to be, indeed, an insufficient measure as the information can be easily manipulated.

Regulators should devote particular attention to the existence of a genuine and effective linkage between effective costs and MIFs. In other words, the level of MIFs should always reflect the costs incurred by the members of the card-payment system with an additional element related to the consideration of the elasticities of the demand on both sides of the market.

More specifically, the reflection of this last element seems to play a crucial role both in the regulation and in the judicial evaluation of MIFs. In order to assess the validity of MIFs, courts should pay particular attention not only to the extent to which MIFs reflect effective costs, but care should also be devoted to the level of elasticity of demand on both sides of the market.

⁵⁹⁷ On this point see S. Semerato, *“Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty”*, above, at p. 988.

Unfortunately, experience seems to suggest that this is rather a difficult task: let us consider, by way of example, a possible increment of interchange fees, the effect of such an increment on each of the two sides of the market is radically different. If the effect on merchants is barely palpable⁵⁹⁸, the impact on consumers can be dramatic⁵⁹⁹. In other words, the cardholders' use of payment cards would tend to be much more reactive to MIFs compared to the merchants' reaction. Courts should therefore devote particular attention to the position of merchants. Even so, the assessment of the legality of MIFs would be far from over.

The next step would be to the assessment of the level of efficiency of the MIFs. Economic analysis suggests that an increment of MIFs despite decreasing costs does not represent a decisive element in order to assess whether interchange fees are determined at an efficient level; here emphasis should be put on the effective use of the interchange fees, that is to say, whether MIFs are used by card issuers in order to transfer more revenue than necessary⁶⁰⁰.

That being the case, it is likely that MIFs so determined entail an abuse. Yet again, the concrete assessment of the validity of MIFs appears to be of difficult application, as concepts like demand elasticity and level of efficiency tend to be, in practice, very intricate. This requires a high level of economic analysis and great discretion on the part of the courts when asked to assess the validity of multilaterally

⁵⁹⁸ In *United States v. Visa U.S.A. Inc.* (163 F. Supp. 2d 332, 340 (S.D.N.Y. 2001)), for instance, it was not possible for Visa representatives to identify a single case of a merchant refusing to accept Visa cards after an increment of MIFs.

⁵⁹⁹ On this point see C.F. Muris, *"Payment Card Regulation and the (Mis)Application of the Economics of Two-sided Markets"*, 2005 COLUM. BUS. L. REV. 515, 542-43. The claim is that "given the presence of alternative payment methods, many consumers would avoid cards rather than paying more".

⁶⁰⁰ On this point see S. Semerato, *"Credit Card Interchange Fees: Three Decades of Antitrust Uncertainty"*, above, at p. 989.

agreed interchange fees, which will of course have to be considered on a case-by-case basis⁶⁰¹.

This regulatory approach appears to be an interesting alternative, but not devoid of negative aspects. Difficulties may indeed arise from the integration of the economic analysis with antitrust law; allowing MIFs equals, as a matter of fact, to embrace their economic justification *tout court*. Consequently, antitrust law should intervene in order to tone down possible negative repercussions on competition. In order to do so, every possible economic aspect of MIFs needs to be carefully weighed by regulatory bodies as well as by courts, as partial economic analysis would lead to misleading conclusions relating to the validity of interchange fees.

Lastly, a regulatory approach allowing MIFs should always allow bypass mechanisms of multilaterally set interchange fees. In this regard, network rules prohibiting bilateral negotiations and additional fees should be declared unlawful.

7.17.3 Regulatory Approaches based on the introduction of a general prohibition of MIFs

The recent Commission Report on card payment systems provides evidence of the fact that MIFs are not necessary elements of card payment systems⁶⁰². Considering their unquestionable anticompetitive aspects, the concluding remarks of the Report appear thus to wipe away the theoretical foundations for possible exemptions of MIFs.

⁶⁰¹ For the scrutiny of VISA debit card MIF, see the recent press release Case COMP/39398 Visa MIF, IP/10/1684, 8.12.2010, in which the Commission announced the decision to make cuts within the region of 60% to VISA debit cards MIFs costs legally binding. This is in line with the reduction of MasterCard MIFs for debit cards announced in 2009 (see Case COMP/34579 MasterCard. See IP/09/515, 1.4.2009).

⁶⁰² See the “*Commission’s Interim Report on Payment Cards*”, above, at p. 88.

A possible regulatory scenario prohibiting MIFs needs to take into account the existence of alternative mechanisms and their possible regulation. As analysed above, one concrete alternative to MIFs is represented by bilateral negotiations. Bilateral negotiations would put banks and merchants belonging to a card-payment system in the position to freely negotiate fees. This would re-establish a more balanced negotiating platform by virtue of which it would be possible to counter balance the card issuers market power with a stronger bargaining position of acquirers and merchants.

An essential condition for the effectiveness of a bilateral negotiations system is the abolition of any type of no-discrimination rules imposing on merchants the obligation to honour all cards issued within a specific card payment network. Such measures are of the outmost importance, as they would reinforce the bargaining position of merchants who would no longer be obliged to accept any branded card issued in a specific network.

Most of all, the prohibition of “honour all cards” rules is indeed necessary for a system of bilateral negotiations to function, as only without no-discrimination rules would merchants be in the position to bilaterally negotiate with card issuers and acquirers.

A regulatory approach introducing a general prohibition of MIFs should put particular emphasis on consumer protection. Bilateral negotiations would, in fact, reinforce the market power of acquirers and merchants who could easily surcharge consumer more than necessary in order to increase profits. Consequently, the first measure to be implemented should be to prohibit merchants from surcharging customers more than the effective transaction costs.

In addition, effective controlling mechanisms would need to be put into force in order to constantly monitor surcharge fees and intervene in cases of abuse. Consumer protection would also require complete transparency and a consequent obligation falling on merchants obliging them to disclose to consumers in advance the entity of any possible fees they would have to accept according to the payment method they choose.

Another necessary measure to be enacted would be the prohibition of any kind of inter-network rules preventing merchants from offering incentives to consumers in relation to the choice of less costly payment mechanisms. Such measures would have a twofold effect: they would in first place reinforce the position of consumers by offering them different alternatives, enhancing at the same time intra-system competition.

Intra-system competition would in this way act in conjunction with bilateral negotiations, representing the real solution to interchange fees⁶⁰³. Only where networks effectively compete for “both sides of the equation, card issuing banks and merchants have the right and ability to use lower cost networks to route transactions to card issuers, can consumer be assured that interchange fees are not just a hidden tax from consumers to banks”⁶⁰⁴.

⁶⁰³ On this point see D. Balto, “*The problem of Interchnage Fees: Costs Without Benefits*”, above, at p. 224. In the U.S., merchants submitted that “the more networks we have the more the competiton we have. The networks assure tha both the issuer and merchant sides’interests in a transaction are covered”. See also Jeffry Kutler, “*Retailers Threatening a Rebellion over Higher Card-Acceptance Fees*”, American Banker 1 (March 17, 1999).

⁶⁰⁴ See Balto, “*The problem of Interchnage Fees: Costs Without Benefits*”, above, at p. 224.

7.18 Conclusions

Card payments represent nowadays the foremost means of payment used by consumers⁶⁰⁵.

MIFs and no-discrimination rules have since the outset been an integral part of any card payment network systems. The analysis of their effective impact on competition has led to almost three decades of antitrust uncertainty.

If it is true, on the one hand, that both MIFs and no-discrimination rules represent blatant restriction on competition; on the other hand, economists have emphasised the peculiar aspects of four party payment networks as two-sided markets and their impact on the antitrust assessment of MIFs and no-discrimination rules.. Within such markets, competitive forces operate in a *sui generis* way so as to render MIFs and no-discrimination rules allegedly essential for the correct functioning of card payment networks. These economic arguments have undoubtedly had an impact on both the US courts, and the European authorities, which fully embraced these economic theories, and generally tolerated (although subject to the imposition of certain requirements) MIFs and no-discrimination rules.

This approach was, thus far, in part justified by the novelty and the progressive success of card payment networks which somehow lead to a cautiously ‘hands off’ regulatory approach due to the risk of compromising the development of a new and very efficient payment system capable of beneficial effects on a large scale.

Now, time is arguably mature enough for a re-assessment of the antitrust implications of MIFs and no-discrimination rules. Empirical evidence appears to

⁶⁰⁵ In Europe , card transactions cover approximately 70 percent of the payment transactions (see the “*Commission’s Interim Report on Payment Cards*”, above, at p. 12.

demonstrate their anti-competitiveness and, most of all, their non-essentiality for the functioning of card payment networks. Alternatives such as bilateral negotiations between the members of card payment systems could represent a feasible and more competition friendly way to recover transactions costs for the members of a four party card payment scheme.

In years to come, competition authorities and regulatory bodies will be asked to re-evaluate MIFs and no-discrimination rules. There are two possible regulatory approaches: keep acknowledging the necessity of MIFs, or declare them unlawful. The former approach (currently adopted by the EU Commission and by the US courts) should aim to mitigate possible anticompetitive side effects through the imposition of disclosure requirements and a strict control on their effective correspondence to transactions costs. In addition, bypassing devices of MIFs (e.g bilateral forms of negotiations) should always be allowed.

The latter solution would remove the possibility to use MIFs within card payment systems allowing bilateral negotiations instead. This approach should put particular emphasis on consumer protection, as consumers might suffer from the consequent possibility for merchants to surcharge clients in order to recover transaction costs. The imposition of disclosure requirements on merchants in relation to fees, in conjunction with a general prohibition to surcharge consumers more than the effective costs require, should ensure consumer protection granting at the same time intra-system competition.

It is submitted that both the above approaches should be based on the illegality of no-discrimination rules as non-necessary for the functioning of card-payment networks, and bearing negative consequences on competition which only with difficulty can be balanced against their alleged positive effects.

8 Non-Price competition Issues in the Banking Sector

8.1 Introduction

The aim of this Chapter is to critically analyse the so-called ‘non-price competition issues’ arising within the context of payment systems. These issues encompass any kind of possible rules relating to access to essential facilities, agreements relating to operative aspects, and membership rules (e.g. the prohibition on participants to adhere to other payment systems).

Although not directly related to price matters, the above behaviours are indeed capable of having a negative impact on competition, and have been the object of scrutiny by the Commission and the European Courts in relation to their compatibility with Art. 101.

This Chapter will principally focus on the EU regulatory approach of non-price competition issues. A comparative element (the US approach) will also be considered in order to identify links with ‘price competition issues’ analysed in the last chapter, and possible alternative regulatory frameworks.

8.2 Access to essential facilities

From an antitrust perspective, any ideally competitive market should always allow access to essential facilities by new participants⁶⁰⁶. Under EU competition law, the so called ‘essential facilities doctrine’ is dealt with in conjunction with both Articles 101 and 102 of the Lisbon Treaty⁶⁰⁷. The ‘essential facilities doctrine finds application to exclusionary practices, (e.g. such as refusals to supply), having a detrimental effect on competition in the relevant market⁶⁰⁸.

The concept of essential facility entails the existence of two markets, an ‘upstream market’ and a ‘downstream market’, together with a dominant undertaking operating in both the upstream and the downstream market⁶⁰⁹. If the dominant undertaking owns an input (the essential facility) and uses that input to compete in

⁶⁰⁶ The concept of essential facilities was for the first time object of antitrust analysis in U.S. The leading case and current jurisprudential point of reference is represented by *MCI Communications Corp. v AT&T*, in which the court identified four essential elements the fulfilment of which establish liability under the “essential facilities doctrine”. These elements are: (i) Control of the essential facility by a monopolist; (ii) Inability of the competitor seeking access to practically or reasonably duplicate the essential facility; (iii) The denial of the use of the facility to the competitor; and (iv) The feasibility of providing the facility. For a detailed analysis of the US position see R. Pitofsky “*The Essential Facilities Doctrine Under United States Antitrust Law*”, 70 ANTITRUST L.J. 443 (2002).

⁶⁰⁷ Since this thesis is designed to tackle the issues related to the application of Art. 101 TFEU to the financial services sector, the analysis of matters arising from abuses of dominant position under Art. 102 will be disregarded.

⁶⁰⁸ The first EU law case relating to the concepts of essential facilities and refusal to deal is *ICI v. Commission*, Case C-48/69 [1972] E.C.R. 619. In this case the ECJ defined the concept of ‘essential facility’ as a “facility or infrastructure without access to which competitors cannot provide services to their customers”.

⁶⁰⁹ See OECD Policy roundtable, “*The Essential Facility Concept*”, available at: <http://www.oecd.org/dataoecd/34/20/1920021.pdf> (accessed on 20 July 2011).

the downstream market, it is extremely difficult for a competitor to seek access to the downstream market. Two elements are therefore necessary: the ownership or control over a "facility" by a dominant undertaking and the 'essentiality' of a facility.

This brings us to the next question: when can a facility be regarded as essential? According to the ECJ in *ICI v. Commission*⁶¹⁰, an essential facility' is a "facility or infrastructure without access to which competitors cannot provide services to their customers".

The concept of essential facility seems therefore to entail that access to the facility must be essential or crucial for the competitor seeking access to survive in that market. The refusal of access to that facility would therefore turn into a barrier to entry, as the facility is in practice incapable of being duplicated.

In the banking sector, mechanisms of exclusions or access denial tend to assume the form of membership rules as analysed in the following.

8.3 Card payment systems: essential facility and membership criteria

All the major payment systems (e.g. Visa, MasterCard, Diner club etc.) adopt access and membership criteria. Depending on their requirements, these rules can indeed prevent external players from having access to what can be surely defined as an essential facility. Further, such rules entail the co-operation between dominant undertakings and are therefore subject to the application of both Article 101 and 102.

That is the reason why the Bank for International Settlements proposed as one of the core principles for systematically important payment systems the full disclosure of the criteria for participation in the system, so as to render access to key

⁶¹⁰ *ICI v. Commission*, Case C-48/69, above.

payment systems open and fair⁶¹¹. The right of external players to have access to the network needs, nevertheless, to be balanced vis-à-vis the investments made by the founders of a payment system⁶¹².

Rules for access having a restrictive effect therefore need to be carefully scrutinised, especially in case payment systems are owned and operated by large banks. It is indeed likely that restrictive access criteria are driven by the desire of the current establishment to retain the benefits of its *status quo*, thus preventing admission to the payment system by external undertakings⁶¹³.

All this ignites the compelling need to seek the right balance between the payment system's safety and competition. The general idea would be that access criteria to payment systems should ideally encourage competition amongst the members in order to promote low cost payment services. Restrictive access criteria should be then carefully assessed in order to carefully weigh any objective justifications for, thus, protecting the safety and the efficiency of the system⁶¹⁴.

Strictly related to access criteria, the so called 'membership rules' give rise to controversial competition issues. Payment card systems, like any other kind of network systems, tend to lay down specific collective rules often limiting the intra-system membership. These rules can assume the form of the so called 'exclusion rules' which prevent competitive financial institutions from having access to the system, or of the form of 'no acquiring without issuing rules' disallowing members

⁶¹¹ See the Bank for International Settlements-Committee on Payment and Settlement Services, "*Core Principles for Systematically Important Payment Systems*", January 2001, Principle IX, p.51-52. Document available at the following link:

<http://www.bis.org/publ/cpss43.pdf>(accessed on 20 July 2011).

⁶¹² *Ibid.* p. 51.

⁶¹³ *Ibid.*

⁶¹⁴ See the Bank for International Settlements-Committee on Payment and Settlement Services, "*Core Principles for Systematically Important Payment Systems*", above, p. 52.

the possibility to participate in the card payment system with the aim of acquiring without issuing.

Obviously, such rules may affect intra-system competition and have therefore been the object of scrutiny by competition authorities both in the US and Europe.

8.4 The *MountainWest* Case and the US position

The current US position relating to access criteria and membership rules stems out from the Court of Appeal decision in *MountainWest (SCFC)*⁶¹⁵. At the core of the dispute was the Visa Bylaw 2.06 laying down one of the access criteria to the US Visa payment system. Under Bylaw 2.06, membership was denied to any applicant issuing, directly or indirectly, Discover or American Express cards, or any other cards which did not belong to the Visa network⁶¹⁶.

This Bylaw effectively restrained access to the Visa network by members of the American Express or Discover systems, and was invoked by Visa in order to deny access to MountainWest (issuer of Discovery Cards).

The rule in question was found by MountainWest to be anti-competitive for two main reasons: firstly, it was claimed that since Visa Bylaw 2.06 prevented access to the US Visa card network it was therefore capable of restricting intra-system competition. Secondly, Bylaw 2.06 was considered harmful for competition as it effectively restrained the creation and diffusion of other proprietary cards.

The main Visa's counter argument to these findings was based on the fact

⁶¹⁵ US District Court, *SCFC ILC, Inc v Visa USA*, 819 F. Supp. 956 (D Utah 1993), reversed by the US Court of Appeal, *SCFC ILC, Inc. v Visa USA*, 36 F.3d 958 (10th Cir. 1994).

⁶¹⁶ US Visa Bylaw 2.06. The Bylaw in question further prevented access to the Visa system in case parents, subsidiaries or affiliates of applicants issued, directly or indirectly, Discover or American Express cards, or any other cards deemed to be competitive by the Board of Directors

that Bylaw 2.06, rather than being anti-competitive, was on the contrary beneficial for competition, as it preserved the disjointed existence of the Discovery card system (one of the main Visa competitors). Furthermore, Visa maintained to have introduced Bylaw 2.06 in order to protect its property from inter-system competitors who otherwise would be capable of enjoying a free ride at the time of their entry⁶¹⁷.

In first instance before the District Court, a jury unanimously pronounced a verdict in favour of MountainWest declaring Visa's Bylaw 2.06 anti-competitive⁶¹⁸. Nevertheless, the District Court's judgment was overruled on second instance by the US Court of Appeal. The line of reasoning of the Court of Appeal relies on a rather interesting interpretation of the main US antitrust piece of legislation (the Sherman Act). The main aim of the Sherman Act is, according to the Court of Appeal, to protect competition *per se*. Consequently, Visa's Bylaw 2.06 did not amount to an infringement of the US antitrust regulatory framework as it ultimately did not cause detriment to consumers⁶¹⁹.

Herein lays the real value of the Court of Appeal judgment in *MountainWest (SCFC)*: the essence of US Antitrust law appears to be more inclined towards consumer welfare/protection rather than on ensuring a level playing field of competition between undertakings.

The consequences of this approach are remarkable, especially as far as non-price competition issues such as access criteria, or membership rules are considered. If the ultimate aim of an antitrust regulatory framework is to safeguard consumers, it consequently becomes inordinately difficult to challenge or breach membership

⁶¹⁷ See US District Court, *SCFC ILC, Inc v Visa USA*, 819 F. Supp. 956 (D Utah 1993), at paragraph. 966 and 973-75.

⁶¹⁸ *Ibid.*

⁶¹⁹ See the US Court of Appeal, *SCFC ILC, Inc. v Visa USA*, 36 F.3d 958 (10th Cir. 1994), at p. 972.

Bylaws or access criteria rules.

The only possible way to do this would be to prove the existence of a link between such rules and consumer welfare; a rather intricate task to perform considering the absence of any price issues to be assessed vis-à-vis consumers.

8.5 Essential facility in the banking sector : the EU perspective, a different approach

In contrast with the US approach, the European Commission considered the delicate competition issues arising from the need of undertakings to have access to essential facilities not only from a consumer protection perspective, but also in relation to the need to create a level playing field in this area of the market.

Further, the Commission devoted serious attention to the concept of access to essential facilities in payment and financial systems in its 1995 *Notice on the application of the EC Competition rules to cross-border credit transfers*⁶²⁰. In this document, the Commission reiterating the line of reasoning expressed by the ECJ in *ICI v. Commission*⁶²¹, considered, *inter alia*, a payment system as an essential facility when membership is “necessary for banks in order to compete in the relevant market”⁶²². In other words, the lack of access to the system “amounts to a significant barrier to entry for a new competitor”⁶²³.

This approach emphasises the primordial necessity to identify the essential facility under its relevant market dimension and gives rise to essential questions

⁶²⁰ See the *Notice on the application of the EC Competition rules to cross-border credit transfers*, of 02/10/1997, OJC 301/7, at paragraph 25.

⁶²¹ Case C- 48/69, *ICI v. Commission* [1972] E.C.R. 619.

⁶²² See the *Notice on the application of the EC Competition rules to cross-border credit transfers*, above, at paragraph 24.

⁶²³ *Ibid.*

relating to the extent of the impenetrability of the barriers to entry which therefore qualifies an essential facility. Whenever an essential facility is identified, any refusal of access to that facility would thus automatically constitute anticompetitive behavior by the undertaking concerned (in this case a bank or a group of banks).

Such conduct would then need to be justified under objective circumstances and weighed against its incidence on competition⁶²⁴.

If the concept of essential facility is applied to the card payment sector, it has been correctly noted that the concept of essential facility appears, within this context, to refer to systems having such a predominant space in the market so as to render it a prohibitive task for outsiders to create alternative networks⁶²⁵.

The key issue here does not seem to lie in the total impossibility of duplicating the existing facility, rather than in the cost effectiveness of putting into place and creating an alternative system. Only if the costs of creating an alternative framework is considered prohibitive, can it be claimed that we are dealing with an essential facility. As a consequence, the undertakings running such a facility cannot justify mechanisms of exclusions or access denial on the basis of the possibility for the market to bear more than one such facility⁶²⁶.

That is the reason why mechanisms of exclusion and membership criteria, according to the Commission's Notice, need to be objectively justified, i.e. be "written, accessible and non-discriminatory"⁶²⁷. They may, for instance, "lay down

⁶²⁴ Objective justifications for a denial of access to an essential facility can have the form of technical or commercial reasons (e.g. the undertaking requiring access to the facility does not have the appropriate financial means or is not technically equipped to provide a specific service), but are of rare incidence and must be considered exceptional. On this point see Luc Gyselen, "*EU antitrust Law in the Area of Financial Services*", above.

⁶²⁵ On this point see Luc Gyselen, "*EU antitrust Law in the Area of Financial Services*", above.

⁶²⁶ *Ibid.*

⁶²⁷ See the *Notice on the Application of the EC Competition Rules to Cross-Border Credit Transfers*, above, at paragraph 26.

requirements for members concerning their financial standing, technical or management capacities, and compliance with a level of creditworthiness”⁶²⁸.

The payment of an entry fee may also be required: however, the entry fee must not be set at so high a level that it becomes a barrier to entry⁶²⁹. In any event, the level of an entry fee must not exceed a “fair share of the real cost of past investments in the system”⁶³⁰, and the membership criteria “should not make membership in the system conditional upon acceptance of other unrelated services”⁶³¹.

Finally, according to the Notice “refusal of membership or definitive exclusion from a cross-border credit transfer system that constitutes an essential facility should be accompanied by a written justification for the reasons for the refusal or exclusion and should be subject to an independent review procedure”⁶³².

Through the Notice the Commission appears to seek find the right balance between the payment system’s safety and competition; this is the essence of the requirement of objectively justified and fully disclosed access criteria.

8.5.1 *The SWIFT Case*

Shortly after the release of the *Notice on the application of the EC Competition rules to cross-border credit transfers*, the Commission had the chance to apply its criteria to a practical situation with the *SWIFT* case⁶³³. SWIFT (Society for Worldwide International Financial Telecommunications), is a co-operative society comprising

⁶²⁸ *Ibid.*

⁶²⁹ See the *Notice on the Application of the EC Competition Rules to Cross-Border Credit Transfers*, above, at paragraph 26.

⁶³⁰ *Ibid.*

⁶³¹ *Ibid.*

⁶³² *Ibid.*

⁶³³ Commission’s Decision , *La Poste SWIFT + GUF*, OJ C 335, 6/11/1997.

approximately 2,000 banks throughout the world. It provides a network for the international processing of order transfer messages, including national and cross-border payment messages, letters of credit etc. Full access to the system was granted only to banks and entities operating in the same type of business. On these grounds, the application of La Poste (the French Post Office) to become member of the SWIFT system was rejected.

Acting on the basis of a complaint received by La Poste, the Commission released a statement of objections against SWIFT for anticompetitive behaviour⁶³⁴.

The Commission argued that SWIFT held a monopolistic position in the field of international payment message transfers. Furthermore, the network was deemed to constitute an essential facility as it was the only network providing links between banks located anywhere around the world. Following the statement of objections released by the Commission, SWIFT agreed to provide access to its network and services on the basis of objectively justified admission criteria to be applied in a non-discriminatory manner. To qualify for SWIFT membership, undertakings were required to satisfy the criteria laid down at that time by the European Monetary Institute (EMI) for access to any European Payment System (e.g., recognition of public nature and of a consequent low risk of failure, and supervision by a recognised competent authority).

The requirement of compliance with the criteria laid down by EMI was considered by the Commission as objectively justified and necessary for the avoidance of systemic risks.

The *SWIFT* case is of paramount importance. Still now it enshrines the

⁶³⁴ In particular, the statement of objections issued by the Commission against SWIFT was based on Art. 82 of the Treaty (now Art. 102 TFEU).

paradigm for admissions criteria to an essential facility, which revolve around the need for finding the right balance between the protection of payment network systems and competition. Above all, the SWIFT case raises some interesting elements of reflection relating to the application of the doctrine of essential facility to the financial services sector.

At an early stage of the proceedings, SWIFT maintained that even assuming the qualification of its network as an essential facility, the rejection of La Poste 's application did not have any appreciable effect on competition. The reason for this was that the SWIFT system (as many financial entities which could be qualified as essential facilities) is a co-operative owned by financial institutions (which are the clients of the system) providing services to a large number of organizations⁶³⁵.

This consideration is extremely important as it leads us to the next level of analysis, and, yet again, to the question of what is the real endeavour of competition law: consumer protection, or rather competitors' protection? The answer to this question is the key to understand the difference in the approach by competition authorities/courts at European level and in US. Furthermore, the consideration of this matter appears to be essential in order to suggest possible alternatives.

If the starting point is that the ultimate aim of competition law is the neoclassical idea of consumer welfare/protection, then the SWIFT case would not have given rise to any antitrust issues. Given the fact that the SWIFT network operated through a large network of worldwide banks connected to it, the exclusion of one institution (La Poste) did not, in practice, have a significant impact on

⁶³⁵ On this point see Faull & Nikpay, *"The EC Law of Competition"*, above, p. 654. Interestingly, Faull & Nikpay draw a parallel between an essential facility in the financial industry and in the transport or telecommunication sectors. In the latter two sectors, the market is structured in a complete different manner and it is characterised by a limited by a limited amount of customers of facility owners who often operate also on the downstream market.

competition on the downstream market for cross-border payment message transfers, and ultimately on consumers.⁶³⁶

As previously mentioned, this approach has been endorsed by the US courts in the *MountainWest* case, and it is now possible to draw a parallel between these two cases.

Both cases deal with the need for an external undertaking to have access to what can be defined as an essential facility according to the essential facility doctrine (a card payment network system in the *MountainWest* case, and the market for cross-border payment message transfers in SWIFT).

The outcome is nevertheless radically different due to a completely different approach of the antitrust regulatory authorities. In Europe, competition law appears to be oriented not only to protect consumers, but also towards the safeguard of competitors⁶³⁷. On the contrary, the US approach leans towards the idea of shielding market end users.

In light of such differences, the *SWIFT* case would have been arguably decided in favour of SWIFT if assessed by US courts, which would have considered the situation essentially from a consumer perspective.

Which approach would be more suitable in order to assess competition issues arising from access to an essential facility in the financial services industry then?

⁶³⁶ On this point see also Faull & Nikpay, “*The EC Law of Competition*”, above, p. 654. Differently from the issue of consumer protection, Faull & Nikpay consider the issue of the protection of competition itself.

⁶³⁷ Both Articles 101 and 102 of the Lisbon Treaty seem to create a comprehensive legal framework aiming at the protection of both consumer and competitors. In particular, Art. 101 (3) provides for an exemption of anticompetitive agreements, decision of associations of undertakings capable of improving the production or distribution of goods or of promoting technical or economic progress, only insofar consumers are allowed a fair share of the resulting benefit.

On the contrary, the Sherman Act is structured in a way which can give rise to different interpretations and approaches (one of the most *éclatant* was the view expressed by the US Court of Appeal in the case *MountainWest*, which focused its attention solely on consumer protection).

The answer to that question is thornier than one may *prima facie* think. It is indeed very difficult to disentangle consumer protection from competitors' protection, as both elements seem to be strictly related to one another. As far as card payment systems are concerned, the larger the number of undertakings participating in the system, the more likely is that consumers would be in a position to choose one that is suitable for them among the operators. All this provided that both inter-system and intra-system competition are ensured.

Access to an essential facility in the financial services seems therefore to represent only one side of the coin. By the same token, there seems to be a need to ensure an adequate level of competition not only in terms of access to the system, but also at inter-system level.

This element appears, with respect, to undermine the US approach. It is indeed questionable whether access criteria like Visa Bylaw 2.06 which prevents card issuers of competitive cards from obtaining Visa membership, do not harm consumer welfare. Indeed, allowing other card issuers belonging to the American Express or the Discover networks to become part of the Visa system (or vice-versa) means not only to protect competition *per se*, but may also result in an enhancement of consumer welfare, provided that inter system competition is also adequately ensured.

All this needs to be counter-balanced against the adequate need for protection required by an already established system, in view of not allowing new participants to enjoy a 'free ride' relying upon previous financial investments necessary for the construction of the system. In this regard, the requirement of objective and non-discriminatory justification suggested by the Commission in its Notice and in the *SWIFT* case appear to be a useful instrument in order to obtain a right balance, but

this may not suffice.

If undertakings can become part of a system but are not free to compete with one another or to adhere to other payment systems, the enforcement of competition would, in fact, remain incomplete. All this will be the object of analysis in the following.

8.6 Exclusivity rules: the prohibition on participants to adhere to other payment systems

The other side of exclusion rules (although not directly related to access criteria) is represented by the so called exclusivity rules. According to such rules, the membership of a card-payment network may be terminated in the event that a member issues payment cards belonging to other competitive systems. Contrary to exclusion rules, exclusivity rules do not restrict access to essential facilities and therefore are more likely to have a negative impact only in relation to inter-system competition⁶³⁸.

In the US, exclusivity rules have been the object of scrutiny in the early 1970s in relation to exclusivity Bylaws adopted by the National Bank Americard (forerunner of Visa) and MasterCharge (predecessor of MasterCard). Nevertheless, the issue relating to the compatibility of exclusivity rules with the Sherman Act was judicially assessed for the first time only in 1980 with the *National Bank of Canada v*

⁶³⁸ It deserves to be outlined that this distinction between exclusion and exclusivity rules is not considered relevant by some academics. See, *inter alia*, J.M. Jacobson, “*Exclusive Dealing, Foreclosure and Consumer Harm*”, Antitrust Law Journal, 2002, Vol. 70, Issue 2, p. 359. It is opinion of this author that, despite the high degree of complementarities characterising exclusion and exclusivity rules, a distinction between these two sets of rules needs to be drawn. As previously mentioned, exclusion rules are strictly related to the access to essential facilities affecting intra-system competition., whereas exclusivity rules often come into play in a secondary moment (once an undertaking acquires the membership of a payment system) reverting against the level of inter-system competition. This distinction is necessary in order to face competition issues arising from card payment systems.

Interbank Card Association case⁶³⁹.

Here controversial issues arose from the adoption by Interbank Card Association (MasterCard) of an exclusivity rule preventing its Canadian members from adhering to other card system payment networks. The rule in question was deemed to be necessary in order to protect the original members' set-up costs insofar as its enforcement was limited in time (that was eight years in anticipation of the recovery of start-up costs).

More interestingly, the court maintained that the "underlying purpose of the exclusivity of the provision was to enhance the competition in the Canadian credit card market by introducing a new product"⁶⁴⁰. Moreover, the court declared that although to some extent the rule had a negative impact on intra-brand competition, it also had the beneficial effect of increasing inter-brand competition.⁶⁴¹

In 1991, Visa USA introduced Bylaw 2.10(e) which provided for the termination of the membership in the event that a member issued competitive cards. Virtually identical to Bylaw 2.06 analysed above, Bylaw 2.10 (e) is completely different in scope, although somehow complementary. If Bylaw 2.06 lays out an access criterion (consequently giving rise to issues relating to the access to an essential facility); Bylaw 2.10 (e) is an exclusivity rule preventing undertakings already members of the Visa network from issuing competitive cards.

Immediately after the introduction of Visa Bylaw 2.10 (e), MasterCard USA

⁶³⁹ US District Court, *National Bank of Canada v Interbank Card Association*, 507 F. supp. 1113 (S.D.N.Y. 1980); confirmed in second instance by the US Court of Appeal in *National Bank of Canada v Interbank Card Association*, 666 F. 2d 6 (2d Cir. 1981). In 1970, National Bank Americard (forerunner of Visa) and MasterCharge (predecessor of MasterCard) decided to withdraw their exclusivity rules spontaneously in order to avoid a judicial litigation.

⁶⁴⁰ See US District Court, *National Bank of Canada v Interbank Card Association*, 507 F. supp. 1113 (S.D.N.Y. 1980), p. 1123.

⁶⁴¹ *Ibid.*

enacted the Competitive Program Policy (CPP) containing similar exclusivity rules. In 2001 both Visa Bylaw 2.10 (e) and MasterCard CCP were the object of judicial scrutiny after the US Department of Justice initiated a legal action vis-à-vis Visa and MasterCard⁶⁴².

In open contrast with the *National Bank of Canada v Interbank Card Association* judgment, the District Court considered the exclusivity rules introduced by Visa US and MasterCard US anticompetitive restrictive of competition in that they were the issuing and network services market. Despite of the defendants' claim that the exclusivity rules represented a mechanism of protection of their systems, the District Court contended that exclusivity rules "undeniably reduce output and harm consumer welfare constituting a violation of Section 1 of the Sherman Act"⁶⁴³.

Yet again, consumer protection appears to be the main issue at stake, and the basis for the antitrust assessment of the court. What is not convincing, with respect, is the opposite outcome of this court decision compared to *MountainWest*. It has been already mentioned that Visa Bylaw 2.10 (e) is virtually identical to Visa Bylaw 2.06, with the only difference confined to the scope of application of the rules. It is opinion of this author that this difference cannot in any way justify such a disparity of approach by the courts. This because Visa Bylaw 2.10 (e) and Visa Bylaw 2.06 represent two faces of the same coin; and, above all, they are both capable of harming consumers.

Turning to exclusivity rules, here it would possible to draw a direct comparison between the US and European approaches, since Visa's intention to introduce an exclusivity rule modelled on the same lines as Visa US Bylaw 2.10 (e)

⁶⁴² See *US District Court, US v Visa USA Inc.*, 163 F. Supp.2d 322 (S.D.N.Y. 2001), p. 382.

⁶⁴³ *Ibid.*, at paragraph. 406 (emphasis added).

in Europe has been in the past object of scrutiny by the Commission.

After receiving complaints from American Express and Dan Witter (the issuer of Discovery Card), the Commission initiated an investigation in January 1996. The investigation never produced an official outcome as it was withdrawn after the EU Board of Visa International decided to drop the proposal for the introduction of an exclusivity rule in Europe⁶⁴⁴.

Despite the lack of an official Commission Decision, the nature of the complaints and, above all, the first response of the Commission represent an interesting platform for discussion. The objections raised by American Express and Dan Witter were related to the negative impact of the proposed rule on competition between banks which would have been prevented from issuing the entire range of payment cards. More specifically, inter-system competition was deemed to be affected as access to the Visa distribution channels would have been impaired by the introduction of the contested exclusivity rule.

The preliminary view of the Commission's Directorate General for Competition endorsed the complaints formulated by American Express and Dan Witter. In particular, the Commission maintained that the proposed rule, if adopted, would have been caught by Art. 101 (1), as it would have impeded inter-system competition and foreclosed access to a key distribution channel⁶⁴⁵.

Here the issue of inter-system competition appears to be particularly interesting. The link between inter-system and intra-system competition (and consequently between exclusion and exclusivity rules) is, in the author's opinion, of

⁶⁴⁴ See European Commission, *Report on Competition Policy* 1996 (Vol XXVI), ISBN 92-828-0298-1, pp. 140-141.

⁶⁴⁵ See European Commission, *Press Release*, IP/96/585, 3 July 1996. See also European Commission, *Report on Competition Policy* 1996 (Vol XXVI), above, point 63.

crucial importance: although they raise different antitrust concerns, inter-system and intra-system competition arguably complement one another. Consequently, once exclusion rules are considered anticompetitive, the same consideration should apply to exclusivity rules, and vice versa.

In this regard, the approach of the US authorities appears to be, with respect, rather idiosyncratic: exclusion rules were endorsed in the *Mountainwest* case, and thereafter exclusivity rules adopted by Visa and MasterCard USA were disallowed. It is submitted that the linkage between exclusion rules and exclusivity rules is so intrinsic and deep as not to substantiate the aforementioned discrepancies.

This contrast in the approach cannot be justified even in light of the court neoclassical interpretation of the Sherman Act as mainly a tool intended to aim at protecting and enhancing consumer welfare. Despite the line of reasoning adopted by the US court in the *Mountainwest* case, it is plausible to claim that exclusion rules are indeed capable of having a negative impact on consumer welfare. Excluding undertakings from a card payment system because they issue competing cards, ultimately means to deprive competition between banks by decreasing the range of products they could provide to customers. And this scenario consequently harms consumer welfare.

The Commission's approach is therefore arguably more coherent than the US approach to the extent that it considers both types of rules against EU competition law.

Before considering possible alternative regulatory frameworks in relation to non-price competition issues and their relationship with price competition factors, the analysis will now shift on to co-operation agreements between banking undertakings.

8.7 Co-operation agreements between banks

It is usual practice for banks to agree standards relating to the operation of specific networks (e.g. settlement agreements), or in relation to security of risks management.

Here the underlying idea is that forms of co-operation between financial institutions which go beyond technical support could indeed represent a threat for competition. Nevertheless, restrictive forms of co-operation between banks which enhance the efficiency of the services may be exempted under Art. 101 (3) provided that they are the least possible restrictive means to achieve their objective⁶⁴⁶.

Examples of such agreements are found in the cases *Irish Banks*⁶⁴⁷ and *Banque Nationale de Paris - Dresdner Bank*.⁶⁴⁸ In *Irish Banks*, the Commission considered an agreement reached by the four foremost Irish banks relating to their opening hours was not capable of distorting competition⁶⁴⁹.

In *Banque Nationale de Paris - Dresdner Bank*, the object of dispute was an agreement providing a close co-operation in the area of international business (international finance, merchant banking and placing of securities). More specifically, the agreements provided for the enactment of a system for the exchange of information and the joint development of data-processing instruments.

The agreement in question was found in breach of Art. 81 EC (now Art.101); nevertheless, the conditions for an exemption under Art. 81 EC (3) (now Art. 101 (3)) were considered to be met. It was held indeed that as a result of the agreement, an

⁶⁴⁶ See the *Notice on the Application of the EC Competition Rules to Cross-Border Credit Transfers*, above, at paragraph 26.

⁶⁴⁷ Commission Decision, *Irish Banks' Standing Committee* [1986] OJ L285/28.

⁶⁴⁸ Commission Decision, *Banque Nationale de Paris - Dresdner Bank* [1996] OJ L188/37.

⁶⁴⁹ Commission Decision, *Irish Banks' Standing Committee*, above, at paragraph 16.

improvement in the production of financial services provided to individuals and undertakings was going to consequently arise from the cooperation between the two banks. In particular, the introduction of new data-processing tools in conjunction with the availability of new sources of financial data was considered ultimately beneficial for the market and thus worthy of exemption⁶⁵⁰.

The cooperation was also deemed to improve the distribution of services and products supplied by the other partner. Interconnection between the data-processing systems was also considered beneficial in order to improve banking services across frontiers, especially cross-frontier payments⁶⁵¹.

Consumers were considered to benefit from the qualitative and quantitative improvements in banking services and their reciprocal distribution via the branches of both and from the setting-up of new forms and means of electronic banking. The clauses relating to cooperation between the two banks were deemed indispensable in order to attain the abovementioned objectives, and an exemption was consequently granted for a ten year period.

8.8 The relationship between price and non-price competition issues

Non price competition issues, although not directly related to price matters, are indeed capable of having a negative impact on competition.

⁶⁵⁰ According to a report submitted to the Commission by the two banks, by transferring existing know-how which involved at least half their activities, the banks were deemed to be able to provide improved or new services to their customers (Commission Decision, *Banque Nationale de Paris - Dresdner Bank*, above, at paragraph 18). The increased efficiency of the system was deemed to be advantageous for customers in view of the creation of new electronic banking services and products, new possibilities relating to account and loan management at national and cross-border level, new forms of information and financial advice and new possibilities for managing capital market transactions, and new types of securities and derivatives.

⁶⁵¹ Commission Decision, *Banque Nationale de Paris - Dresdner Bank*, above, at paragraph 18.

Exclusion rules and exclusivity rules are very controversial from a competition perspective. On the one hand these rules grant a form of protection to payment systems, as the establishment of these systems is in fact the result of huge investments by their founders, who consequently are not inclined to allow external players to have a free ride. On the other hand, important competition concerns arise especially when these systems can be qualified as essential facilities according to the essential facility doctrine.

The need for protection of the system must be counter-balanced against the necessity for competition, both at an intra-system and inter-system level. It has been emphasised that although exclusion rules give rise to intra-system competition concerns (whereas exclusivity rules are instead related to inter-system competition), indeed these two different sets of rules represent two sides of the same coin. Similarly, intra-system and inter-system competition are arguably strictly inter-related.

Consequently, it is submitted that the regulation of these two issues should be considered on a *pari-passu* basis. The US approach aiming at ensuring an adequate level of competition at inter-system level alone, might in practice result in undermining intra-system competition in the long run. By way of comparison, the approach of the Commission which considers both exclusion and exclusivity rules to be at odds with EU competition law has the added benefit of coherency, especially if the linkage between price and non-price competition issues is considered.

It is indeed submitted that price competition issues analysed in the previous Chapter and non-price competition issues are strictly related to one another. If MIFs and NDRs used by card payment systems raise issues related to intra-system competition, non-price competition agreements such as exclusion or exclusivity rules

revert both to intra and inter system competition. We are basically dealing with two sides of the same coin. This is the reason why it is suggested that both non price and price competition agreements should be subject to a similar regulatory framework. Nevertheless, it is of the utmost importance to determine what kind of framework: should they be subject to a block exemption regime on the same line as the insurance industry? Or should both banking and insurance industries be completely exposed to open competition as other industries?

In the last Chapter of this thesis we shall endeavour to provide an answer to these questions. Our attention shall now turn to the regulation of forms of horizontal co-operation in different sectors of the economy (i.e. energy and telecommunication) with a view of identifying, by way of comparison, ‘outward’ tools for decoding the questions this thesis is designed to tackle.

PART IV - ART 101 AND THE ENERGY AND TELECOMMUNICATIONS SECTOR

9 Art. 101 and the Financial Services Sector: a comparative perspective with the Energy and Telecommunications Sectors

9.1 Introduction

In the previous parts of this thesis we identified the most complex issues arising from the application of Art. 101 TFEU to the financial services sector. We established that forms of co-operation capable of being caught by Art. 101 are extensively present both in the insurance industry and in the banking sector.

It has been also emphasised how these forms of co-operations have been traditionally justified due to the arguably *sui generis* nature of the banking and insurance services, and consequently tolerated by way of a block exemption in the insurance industry, and through a relaxed application of Art. 101 in the banking sector. We also critically considered the rationale and real impact of these forms of co-operation on the market, suggesting in each case a different regulatory regime.

Here we shall proceed above and beyond the ‘internal’ line of reasoning pertaining to the financial services industry and draw a comparison between the application of Art. 101 in this area and different segments of the market.

All this in the quest for the identification of possible rebuttals or confirmations of the findings of previous parts of the thesis, with a view of setting the scene for the last part of the conceptual journey of this “literary vessel”.

9.2 Setting the Scene: Art. 101 and forms of horizontal co-operation in the Telecommunications and Energy sectors

More than focusing the analysis on the general application of Art. 101 TFEU by the Commission and the European Courts, it is opinion of the author that for the purpose of this thesis it is worthwhile to channel the attention to the telecommunications and energy sectors.

The rationale for this choice lies with the similarities which characterise these two sectors if compared to the financial services industry. In the first place, both the telecommunications and the energy industries provide, just like insurance and banking undertakings, services rather than ‘material goods’.

Secondly, similarly to the provision of banking and insurance services, telecommunications and energy can be defined as essential facilities denoting a *quasi*-social nature which is somehow difficult to be reconciled with competition law.

Just like with the financial services sector, the provision of telecommunications and energy services traditionally used to be a state prerogative, and the two sectors were also subject to a process of liberalisation and integration similar to the ones which characterised the financial services⁶⁵².

In economic terms, apart from circumstances which are peculiar to each of the markets considered and capable of distinguishing them individually, the main differential element between telecommunications, energy services and the banking and insurance seems to lie with the concept of risk.

⁶⁵² The EU process of liberalization and integration of the energy markets started in the early nineties with the adoption of Directive 90/377 (*Council Directive 90/377/EEC of 29 June 1990 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users* [1990] OJ L176/1). Directive 90/377 was followed by a first wave of liberalization for the electricity and gas markets which comprised Directive 90/547 (*Council Directive 90/547/EEC of 29 October 1990 on the transit of electricity through transmission grids* [1991] OJL313/30, and Directive 91/296 (*Council Directive 91/296/EEC of 31 May 1991 on the transit of natural gas through grids* [1991] OJL147/37). The process of integration in the energy sector was subsequently integrated at the beginning of the new millennium through the enactment of a further series of directives which included Directive 2003/54 (*Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity* [2003] OJ176/37), and Directive 2003/55 (*Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas* [2003] OJ176/57). As for the telecommunication sector, the lion share of the process of integration of the European markets was enacted in the early 2000, with the adoption of a series of Directive whose aim was the harmonisation of the conditions of access, interconnection and provision of telecommunication services across the internal market. The most important directives are Directive 2002/19 (*Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive)* [2002] OJL 108/7, Directive 2002/21 (*Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive)* [2002] OJ L 108/33); Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), [2002] OJ L 108/51; Directive 2002/20/EC of the European Parliament and of the Council of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive) OJ L 108/37; Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) [2002] OJ L 201/35; Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communications networks and services [2002] OJ L 21. Commission Directive 2002/77/EC of 16 September 2002 on competition in the markets for electronic communications networks and services [2002] OJ L 249/21. The current point of reference for the telecommunications sector is represented by Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009 amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and 2002/20/EC on the authorisation of electronic communications networks and services [2009] OJ L 337/37.

Financial products, especially insurance services, are characterised by a high degree of uncertainty which is almost absent in the telecommunications and energy industry (although any business is, *per se*, characterised by an element of risk of course).

Nevertheless, this economic differentiation on its own arguably does not seem to represent a solid justification for a differential antitrust regime, as the risk factor could be circumvented by different means rather than a blank exemption from the application of Art.101⁶⁵³.

If the argument of risk as a mitigating factor for the full application of Art. 101 to the financial services sector can be set aside, is there any justification for a separate treatment for the financial services industry compared to different sectors such as energy or telecommunications then?

In order to answer this question, we shall now proceed with the analysis of the application of Art. 101 to the energy and telecommunications industry.

9.3 Art. 101 and the Energy Sector

From an antitrust perspective, the application of Art. 101 to the energy sector poses similar questions to the ones we explored in relation to the financial services industry.

As established in the course of this thesis, the application of Art. 101 to the financial services sector gives rise to antitrust complexities mainly in the form of horizontal co-operation between undertakings. When it comes to the energy sector, a strong “vertical element” of co-operation between undertakings is present, *inter alia*,

⁶⁵³ See Chapter 3 above.

in energy supply contracts containing use restrictions clauses⁶⁵⁴, long term exclusive purchase obligations⁶⁵⁵ and exclusive supply clauses⁶⁵⁶.

Intentionally, vertical issues shall not be taken into account for reasons of conceptual and teleological coherence. The analysis shall then solely focus on horizontal forms of co-operation such as information sharing agreements, issues related to the access to new infrastructures, and agreements for standardising access conditions on existing infrastructures, which largely characterise the energy sector.

9.3.1 *Information sharing agreements*

The high competition sensitiveness of information sharing agreements in the financial services sector has been already established in the course of this thesis⁶⁵⁷. On a general level, the severity of the impact on the market of such agreements is epitomised by the fact that the Commission *Guidelines on horizontal cooperation agreements*⁶⁵⁸ do not deal with horizontal exchanges of information due to their extremely anticompetitive nature.

The extreme anticompetitiveness of information share agreements was indeed recognised as early as in the early seventies in *Papiers Peints de Belgique v Commission*.⁶⁵⁹

⁶⁵⁴ See, *inter alia*, Commission decisions *Endesa/GasNatural*, IP/00/297, and *DONG/DUC*, IP/03/566.

⁶⁵⁵ For a detailed analysis of long terms exclusive supply agreements, see A.Arben Lorens “Long Term Exclusive Supply Agreements in the Gas Sector”, 2002, *Fordham International Law Journal*, 909 (915).

⁶⁵⁶ See, *inter alia*, Commission decisions *Gazprom/Eni*, IP/03/1345, and *OMV*, IP/05/195.

⁶⁵⁷ See Chapters 3-6 above.

⁶⁵⁸ Commission “*Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements*” [2001] OJ C3/2.

⁶⁵⁹ *Case 73/74 Papiers Peints de Belgique v Commission* [1975] ECR 1491, paragraph 33)

Subsequently, in *Fiatagri UK Ltd and New Holland Ford Ltd v Commission*,⁶⁶⁰ the European Court of Justice pointed out that “an agreement creating an information exchange system which does not concern prices and does not underpin any other anti-competitive arrangement is likely, on a truly competitive market, to lead to the intensification of competition between suppliers, since the fact that a trader takes into account information made available to him in order to adjust his conduct on the market is not likely, having regard to the atomized nature of the supply, to reduce or remove for the other traders any uncertainty about the foreseeable nature of its competitors' conduct”⁶⁶¹.

We have seen that information sharing agreements for the joint studies of statistical data are currently exempt in the insurance sector by Regulation 267/2010. Further, information sharing activities are invariable (to one extent or the other) entailed in the determination of multilateral interchange fees within the context of card payment systems. It is therefore worthy of interest to explore the way in which similar issues are dealt with in a comparable industry.

In the energy sector, information agreements capable of impairing competition were allowed by the Commission in *International Energy Agency*,⁶⁶² where an agreement designed to face oil supply disruptions by ensuring the enactment of specific structural measures for emergencies was considered lawful despite the heavy exchange of information involved.

Apart from the Commission decision in *International Energy Agency*, forms of information exchange were considered legitimate in the creation of the ‘Eutelia’ web network. Owned by eleven leading European electricity utilities, the Internet

⁶⁶⁰ Case T-34/92 *Fiatagri UK Ltd and New Holland Ford Ltd v Commission*, [1994] ECR II-905.

⁶⁶¹ *Ibid.*, at paragraph 7.

⁶⁶² Commission Decision *International Energy Agency* of 21 February 1994 relating to a proceeding under Article 85 of the EC Treaty, [1994] OJ L68/35.

portal Eutilia provides business to business (B2B) services in the electricity sector. The creation of Eutilia was cleared by the Commission. Nevertheless, its actions were deemed capable of being caught by Art. 101 in case of exchange of market-sensitive information between the undertakings involved in the network⁶⁶³.

Interestingly, the doctrine pointed out that in case of creation of network systems such as Eutilia, the *escamotage* most commonly used in practice to circumvent the application of Art. 101 TFEU is the appointment of an independent body whose task is the management of the data flows and of the electronic market.⁶⁶⁴

It is even more interesting to note that, despite the unquestioned importance of information sharing agreements in the energy industry, this sector has been subject of intense scrutiny by competition authorities and no exemption was granted on a large scale.

These considerations will ignite a further wave of comparative analysis in the following. The attention shall now turn to the issues related to the access to infrastructures.

9.3.2 Access to infrastructures

Just like with card payment systems, access to essential facilities such as infrastructures in the energy sector gives rise to serious competition concerns.

We have already seen that the main difficulty under these circumstances is to counterbalance the investment and costs of the undertakings involved in the set-up of a new infrastructure *vis-à-vis* the need to grant access to third parties in order to diminish exclusivity and enhance competition.

⁶⁶³ See Commission Press Release IP/01/1775

⁶⁶⁴ On this point see Faull&Nickpay “*EC Competition Law*”, above at p. 1435. See also M. Albers, “*Competition Law & the Energy Markets*”, Claeys & Casteels, 2005, p.115.

In the energy sector, competition concerns arise especially in relation to the creation of new infrastructures for the supply of gas and electricity services. Contrary to the financial services sector, the regulation of third party access to transmission frameworks in the energy sector is currently dealt with by legislative measures, namely Regulation 715/2009⁶⁶⁵ and Directive 2003/54.⁶⁶⁶

Regulation 715/2009 regulates the conditions to access to the natural gas transmission networks setting up minimum standards of access in practice throughout the Community, so as to ensure third party access⁶⁶⁷. In order to achieve this aim, the Directive provides for requirements of transparency of tariff and for requirements of non-discrimination of new entrants,⁶⁶⁸ allowing exchange of relevant information among the market participants deemed necessary in order to ensure the correct functioning of the system⁶⁶⁹. Similarly, as far as horizontal forms of co-operation are concerned, Directive 2003/54 aimed at ensuring the possibility of access by third parties to electricity transmission and distribution systems through the imposition of transparent tariffs and the prohibition of any type of discrimination.⁶⁷⁰

Despite the introduction of the above key legislative measures, competition concerns are likely to arise whenever the undertakings members of a specific distribution/transmission networks jointly agree conditions for access or fees. This happened in Germany with the creation of the “*Verbandvereinbarungen*” , i.e. association agreements between network operators encouraged by the German

⁶⁶⁵ Regulation (EC) No 715/2009 of 13 July 2009 on conditions for access to the natural gas transmission networks OJL 211/36.

⁶⁶⁶ Directive 2003/54/EC of the European Parliament and the Council of 2003-06-26 concerning common rules for the internal market in electricity OJ L 176/37.

⁶⁶⁷ See Regulation (EC) No 715/2009, above, Recital 10.

⁶⁶⁸ *Ibid.* Articles 13 and 14.

⁶⁶⁹ *Ibid.*, Recital 24.

⁶⁷⁰ See Directive 2003/54, above, Art. 20.

government due to the technical difficulties incurred by individual undertakings in creating their own access system.⁶⁷¹

Similarly to the agreements which surround the membership agreements for credit card systems, the Verbandvereinbarungen agreements provided for common criteria for the calculation of fees and common access rules. More interestingly, despite the fact that exactly like multilateral interchange fees, the Verbandvereinbarungen agreements clearly contained price fixing elements, they were also deemed to reduce transaction costs for third parties seeking access and ultimately beneficial for consumers.⁶⁷²

The issues surrounding the areas of information exchange and access and regulation of essential infrastructure in the energy industry, arguably comparable with the ones arising in the financial services sector, will ignite a detailed comparative scrutiny in the last part of this chapter.

The attention shall now focus on the telecommunications sector in order to identify possible further elements of analysis.

9.4 Art. 101 and the Telecommunications Sector

Forms of horizontal co-operation in the Telecommunications sector capable of being caught by Art. 101 arise mainly in relation to the establishment and/or the management of communication networks. As it will be readily appreciated, such forms of co-operation invariably entail information exchange elements.

From an antitrust perspective, just as we have seen in the financial services sector and in the energy sector, the assessment of network sharing agreements needs

⁶⁷¹ See M. Albers, “*Competition Law & the Energy Markets*”, above, p.123-124.

⁶⁷² See Faull & Nickpay “*EC Competition Law*”, above at p. 1449.

to take into account, *inter alia*, the necessity and cost effectiveness of the agreement which needs to be counter-balanced vis-à-vis possible negative spill over effects against costumers.

Network sharing agreements in the telecommunications sector are nowadays quite common especially in the mobile and internet services. Nevertheless, the jurisprudence in this area is limited due to fact that after the introduction of Regulation 1/2003⁶⁷³, undertakings have the possibility to self-check the compatibility of their agreements with Art. 101⁶⁷⁴.

Prior the entry into force of Regulation 1/2003, two cases of network sharing raised competition concerns worth of analysis as to the identification of possible comparative elements to be taken into account in respect to the financial services sector.

The first case is *O2 UK Limited/T-Mobile UK Limited*⁶⁷⁵. Here the antitrust controversial issues revolved around an agreement between O2 and T-Mobile for infrastructure sharing and national roaming on the UK market for the third generation of mobile telecommunications networks. The Commission found the agreement to be competition sensitive due to the extent of co-operation between two leading players in a market characterised (just as the credit card services market, or by way of comparison the insurance sector) by a limited number of competitors and “high, if not absolute, barriers to entry”.⁶⁷⁶

⁶⁷³ Council Regulation (EC) 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty OJ L1/1.

⁶⁷⁴ On this point see G.M. Borges, “*Co-investment in NGAs and competitive assessment of horizontal cooperation agreements*”, 2010, PLUG APRITEL, p. 3.

⁶⁷⁵ Commission Decision *O2 UK Limited/T-Mobile UK Limited*, of 7/8/2003 Case COMP/38.370, OJL 200/59.

⁶⁷⁶ *Ibid.*, at paragraph 81.

In the words of the Commission, such kind of agreements may have an “adverse impact on competition, in particular by reducing network competition, denying competitors access to necessary sites and site infrastructure, thus foreclosing competitors and, possibly in some cases, facilitating collusive behaviors.”⁶⁷⁷ Despite its clearly potential anticompetitive effects, the agreement obtained clearance by the Commission in light of the regulatory remedy provided by the Framework Directive.⁶⁷⁸

The Directive at issue provided for the possibility of forms of legislative obligations of network sharing to be superimposed by Member States on telecommunications undertakings. This regulatory framework was devised in order to offer a wide-reaching solution in case of possible anticompetitive effects of network agreements in terms of access denial to specific sites and/or site infrastructure by potential competitors.⁶⁷⁹

The rationale for the exemption of a network sharing infrastructure which could be to some extent compared to card payment systems in the financial services sector, in *O2 UK Limited/T-Mobile UK Limited* was linked to the existence of a regulatory framework (absent in the banking and insurance sectors) capable of mitigating potential negative effects.

Another form of regulatory intervention regarding the application of Art. 101 to the telecommunications sector is provided by the Commission Guidelines on the application of EU competition rules in the telecommunications sector.⁶⁸⁰ The

⁶⁷⁷ See Commission Decision *O2 UK Limited/T-Mobile UK Limited*, above, at paragraph 84.

⁶⁷⁸ Directive 2002/21/EC, above, Art.12.

⁶⁷⁹ See Commission Decision *O2 UK Limited/T-Mobile UK Limited*, above, at paragraph 104.

⁶⁸⁰ Commission Guidelines on the application of EEC competition rules in the telecommunications sector 1991/C 233/02, *OJ C* 233/2.

Guidelines allow the possibility for exemption of specific co-operation agreements⁶⁸¹ re-emphasising, nevertheless, the competition sensitivity of agreements containing price fixing or information exchange elements.

More specifically, the latter could be considered necessary for the good functioning of international telecommunications services, insofar as the exchange of information remain confined to the need for cooperation aimed at ensuring interconnectivity and it is not extended to competition-sensitive information.⁶⁸²

A further interesting case related to horizontal cooperation in the telecommunications is *T-Mobile Deutschland/O2 Germany*⁶⁸³. In this case, the decision of the Commission not to grant clearance to a national roaming agreement between T-Mobile Deutschland and O2 Germany was based upon an overall antitrust reprimand of infrastructure agreements. Such agreements were deemed by default to “restrict competition between operators in all related network markets on key parameters such as coverage, quality and transmission rates”⁶⁸⁴.

Interestingly, this line of reasoning was completely disregarded by the Court of First Instance⁶⁸⁵, which emphasised the need to conduct an antitrust assessment of the agreement in question in line with the Guidelines on the application of Article

⁶⁸¹ *Inter alia*, agreements concerning terrestrial facilities (public switched network or leased circuits) or services, see Commission Guidelines on the application of EEC competition rules in the telecommunications sector, above, at paragraphs 38,39,40, 41.

⁶⁸² Such as “tariff information which constitutes business secrets, discounting, customers and commercial strategy, including that concerning new products”(see Commission Guidelines on the application of EEC competition rules in the telecommunications sector, above, at paragraph 53).

⁶⁸³ Commission Decision *T-Mobile Deutschland/O2 Germany*, Case COMP/38.369, 16.06.2003. OJ L 75/32.

⁶⁸⁴ See the Commission Decision *T-Mobile Deutschland/O2 Germany*, above at paragraph 107 (emphasis added).

⁶⁸⁵ *O2 Germany v. Commission*, Case T-328/03 [2006] ECR II-1231.

81(3) of the Treaty (now Art. 101 TFEU) “within the actual context in which it would occur in the absence of the agreement in dispute”⁶⁸⁶.

The interference with competition, according to the Court, may in particular be doubted if “the agreement seems really necessary for the penetration of a new area by an undertaking”.⁶⁸⁷

Another interesting point of the judgment is where the Court emphasises the need for consideration of a theoretical scenario to be construed in the absence of an agreement, especially within the context of markets undergoing liberalisation or emerging markets. Under those circumstances, in absence of a network agreement, “effective competition may be problematic owing, for example, to the presence of a dominant operator, the concentrated nature of the market structure or the existence of significant barriers to entry.”⁶⁸⁸

The outcome of this sort of “reversed” analysis lead the Court to conclude that it could have not be excluded that the agreement concluded by T-Mobile Deutschland and O2 Germany instead of restricting competition between network operators, was, on the contrary, capable of “enabling, in certain circumstances, the smallest operator to compete with the major players.”⁶⁸⁹

The features of a market undergoing liberalisation heavily characterise also the financial services sector. The considerations expressed by the Court in *O2 Germany v. Commission* will be, thus, carefully considered in the following in conjunction with the observations made in relation to the energy sector.

⁶⁸⁶ See *O2 Germany v. Commission*, Case T-328/03, above at paragraph 68. See the Guidelines on the application of Article 101(3) of the Treaty of 27.4.2004, *OJ C 101/ 97*, paragraph 22.

⁶⁸⁷ *Ibid.*

⁶⁸⁸ *Ibid.*, at paragraph 72.

⁶⁸⁹ *Ibid.*, at paragraph 109.

9.5 The Energy, Telecommunications and the Financial Services Sectors: a comparative perspective

Throughout the course of this thesis, a common thread has been established between the insurance and banking sectors, and so far the issues related to the application of Art. 101 to the financial services sector have been subject to intense scrutiny from what may be defined as an ‘inward looking perspective.’

As established at the outset of this chapter, the aim here was to adopt an ‘outward looking point of view’, considering how forms of horizontal cooperation are faced in the energy and telecommunications sectors, i.e. two sectors with characteristics arguably comparable with the financial services sector.

We have seen that the main controversial issues arising from the application of Art. 101 to the energy and telecommunication sector relate to the management and access to network systems capable of being characterised as essential facilities. This is arguably the foremost similarity between the energy, telecommunications and the financial services sector.

It is important to note now that points of contact which *prima facie* seem to arise not only in relation to the card payment banking, could be indeed extended far beyond that horizon, embracing forms of non-price competition in the banking sector as well as the insurance sector. The reason for this is to be found in the nature of the services provided by the industries considered, which are very different in substance, but comparable under structural aspects.

It is opinion of this author that strong similarities arguably exist between the energy, telecommunications and financial industries in the way that the creation of infrastructure networks is needed for the provision of services.

The similarities between network infrastructures in the telecommunication energy and banking sectors are very evident if the card payment systems are considered. Exactly as for the provision of gas/electricity and, for instance, telephone services, we have seen that the provision of card payments is the outcome of the creation of a network infrastructure without which the provision of the service is virtually impossible.

Nevertheless, far from being confined to the banking sector, the same similarities may arguably be extended also to the insurance sector. As we established in the first part of this thesis, the provision of insurance services is based on the exchange of information on statistical data between large insurance associations. This system could indeed be defined as a network infrastructure not too dissimilar from the ones characterising the other industries taken into account⁶⁹⁰.

The existence of a sort of network infrastructure in the insurance industry appears to have been implicitly acknowledged by the Commission through the enactment of a block exemption for the exchange of information between insurance undertakings.

We have seen that the *raison d'être* for the block exemption in this area is the acknowledgment of the need for cooperation between insurance undertakings, which individually could not be in the position to create or have access to large statistical data necessary to determine premiums and face uncertainty.⁶⁹¹ This arguably creates a network infrastructure which gives rise to the same competition concerns as those arising in the banking, energy and telecommunication sectors.

⁶⁹⁰ See Chapter 3 above.

⁶⁹¹ See Chapter 3 above.

We are therefore dealing with different sectors of the market characterised by similar network structures, which ignite similar antitrust anxieties in relation to the application of Art. 101.

Similar structures, similar competition concerns, but different regulation. It is now time to consider whether there are elements to be taken into account or lessons to be learnt by the application of Art. 101 to the energy and telecommunication sectors, and if the considerations made so far in this chapter weaken or reinforce the conclusions reached in the previous parts of this thesis in relation to the financial services sector.

9.6 The application of art. 101 to the energy and Telecommunication sectors: Lessons to be learnt?

The existence of structural similarities and comparable antitrust concerns arising from the Application of Art 101 have arguably been established between the financial services sector and the telecommunication and energy sectors. It is now time to draw a comparative line between the difference in terms of regulatory regimes for horizontal forms of co-operation in these sectors of the market.

The starting point is the fact that structural similarities arguably exist between these different industries. This does not necessary mean that the application of Art. 101 needs to reflect them, and that forms of horizontal cooperation in the financial services sector should be treated in the same was as in the telecommunications and energy markets. Comparative elements arising from the telecommunications and energy scenarios will be used primarily to test the validity of the conclusions in relation to the application of Art. 101 to the financial services sector so far reached by this thesis.

From a comparative perspective, the most important and evident difference between the financial services sector and the telecommunications and energy industries is the presence of a block exemption for the insurance sector, which, despite its recent remarkable reduction in scope, still regulates this area of law.

This thesis has resoundingly rebutted the need for a block exemption in the insurance sector. Can this conclusion find additional support in the considerations related to the application of Art. 101 to the energy and telecommunications industries made above?

The fact that, in spite of structural similarities the energy and telecommunication industries do not benefit from a block exemption appears *prima facie* to corroborate the observations made in relation to the insurance block exemption. Nevertheless, the analysis needs to be extended far beyond those unsophisticated considerations, embracing the essence of the rationale for an exemption to be applied on a large scale.

We have established that the *raison d'être* for the enactment of the block exemption in the insurance sector lies with the absolute necessity of co-operation and information exchange between insurers. If we consider the case law, as far as the energy sector is concerned, we have seen that forms of cooperation capable of impairing competition were allowed by the Commission in *International Energy Agency*,⁶⁹² by reasons of absolute necessity. The same rationale was also applied in the telecommunications sector in *T-Mobile Deutschland/O2 Germany*.⁶⁹³

The element of necessity of an infrastructure network was considered by the European Court in *T-Mobile Deutschland/O2 Germany* in light of the possibility of

⁶⁹² Commission Decision *International Energy Agency* of 21 February 1994 relating to a proceeding under Article 85 of the EC Treaty, [1994] OJ L68/35.

⁶⁹³ Commission Decision *T-Mobile Deutschland/O2 Germany*, Case COMP/38.369, 16.06.2003. OJ L 75/32.

market entry by small undertakings. In other words, according to the Court in *T-Mobile Deutschland/O2 Germany*, the necessity for a 'network system' needs to be assessed not only in terms of functionality for the provision of services, but also in consideration of possible anticompetitive spill over effects *vis-à-vis* new market entrants.

If we apply the same line of reasoning to the insurance and banking sector, the conclusions to be drawn seem to be in line with the considerations made so far in this thesis.

For instance, let us consider the necessity for cooperation in the insurance industry in light of the Court's judgment in *T-Mobile Deutschland/O2 Germany* from a teleological and conceptual perspective, going beyond the substantive differences between the provision of insurance and telecommunications services.

The questions to be answered here appear to be mainly two: are forms of co-operation between insurance undertaking necessary in order to provide insurance services? If so, are network elements capable of having a positive impact on new market entrants? We have seen that *prima facie* the answer to these two questions appear to be positive: forms of cooperation are deemed to be necessary in order to allow insurers to determine insurance premiums, and ultimately access to these forms of cooperation would be the only way for new players to enter into the market.

Nevertheless, we have also established that, apart from peculiar scenarios arising from specific types of risk (e.g. nuclear, terrorism etc.) and specific lines of insurance (i.e. re-insurance), the entire conceptual castle built around the necessity for co-operation between insurers could arguably be dismantled by way of alternative regulatory solutions (i.e. insurance transcripts and tailor-made insurance policies).

Furthermore, in *O2 UK Limited/T-Mobile UK Limited*⁶⁹⁴ cooperation between undertakings was tolerated in view of the possibility for Member States to impose network sharing obligations *vis-à-vis* existing undertakings forming part of an infrastructural network. Here a regulatory framework introduced through a Directive was seen as a mitigating factor for possible anticompetitive effects arising from network sharing agreements. In the absence of a similar regulatory solution in the financial services sector, the justification and relative exemption of infrastructure agreements is arguably more difficult.

When it comes to the banking sector, an interesting parallel could be made with the situation arising from the creation of the “*Verbandvereinbarungen*” in the energy sector. As established above, similarly to multilateral interchange fees agreements, the *Verbandvereinbarungen* agreements provided for common criteria for the calculation of fees and common access rules.

More interestingly, despite the fact that exactly like multilateral interchange fees, the *Verbandvereinbarungen* agreements clearly contained price fixing elements, they were also deemed to ultimately reduce transaction costs for third parties seeking access and ultimately for consumers.

This seems arguably to reinforce the conclusions reached in relation to the regulation of multilateral interchange fees, where the need for mechanisms of control of cost efficiency of the fees was advocated in order to avoid possible negative spillover effects against consumers.

If the line of reasoning applied in relation to the assessment of the *Verbandvereinbarungen* agreements was to be considered in relation to multilateral interchange fees and no-discrimination rules, the key criterion for their antitrust

⁶⁹⁴ Commission decision *O2 UK Limited/T-Mobile UK Limited*, of 7/8/2003 Case COMP/38.370, OJL 200/59.

evaluation would revolve around the capability of these agreements to curb transaction costs and not to reverberate against third parties seeking access to the network or consumers.

The outcome of such assessment would arguably lead to the need for strict forms of control on the effective correspondence of multilateral interchange fees to transactions costs.

The same considerations are arguably valid if network agreements in the banking sector such as the SWIFT or the *Dresdner Bank* circuit analysed above⁶⁹⁵ are taken into consideration. In both cases, the possibility to reduce transaction costs and improve services for consumers would lead to the judicial admissibility of co-operation agreements, with a caveat advocating for strict mechanisms of cost-efficiency control, which are not currently enacted.

Overall, the main lesson to be learnt by the application of Art. 101 to the telecommunication and energy sectors appears to be that, in absence of any block exemption, a careful assessment of forms of co-operation between undertakings in the financial services sector would be advisable. This could be accompanied by the imposition of an obligation of notification of such agreements to the Commission, circumventing any possibility of self-assessment procedures in relation to the possible compatibility of such agreements with Art. 101.

It is opinion of this author that only through a careful and meticulous scrutiny of the nature of proposed agreements between insurance or banking undertakings stability in the market and enhancement of competition in the financial services sector can be attained.

⁶⁹⁵ See Chapter 8 above.

In line with the considerations expressed in the course of this thesis in relation to forms of horizontal co-operation in the insurance and banking sector, particular emphasis should be put on the indispensability of the agreements and efficiency claims and cost efficiencies should be carefully counter-balanced vis-à-vis restrictions and impact on consumers.

More specifically, in absence of a block exemption regime once established that particular forms of horizontal co-operation between undertakings in the financial services sector are indispensable for the current functioning of the industry (e.g. agreements on information exchanges between insurers or on multilateral interchange fees between banks), efficiency gains stemming out of such forms of co-operation should be carefully assessed in order to prevent possible abuses.

This would imply a particularly high burden of proof falling on the shoulders of insurers and banks under Art. 103(3); nevertheless, this high burden of proof would also act as a deterrent for collusive behaviors in the financial services industry. Under this scenario, insurers and banks would be obliged to carefully assess possible efficiency gains prior the enactment of any forms of horizontal co-operation. Since according to Art. 101(3) efficiency gains need to be ultimately passed on to consumers, the ultimate burden of proof would be to justify how that specific form of horizontal co-operation benefit consumers. By way of example, when it comes to agreements on exchange of information between insurers, the key issue would be to demonstrate that a specific exchange of information would help consumers in making their informed choices reducing their search costs. According to the Commission's Guidelines on the applicability of Article 101 on horizontal co-

operation agreements⁶⁹⁶, this is likely to happen in case the exchange of information involves publicly available information. Rendering the information object of the exchange publicly available would be the natural evolution of the current insurance block exemption regime which, as established in the above, requires calculations and studies to be made available not only to all insurance companies, but also to consumer and customer organisations which request them⁶⁹⁷.

By the same token, in the banking sector any agreement on multilateral interchange fees, apart from being justified in terms of cost effectiveness would need to be justified in terms of consumer gains. This is in line with what happened with the Mastercard interchange fee analysed above.

It is submitted that although the burden of proof on undertakings operating in the financial services sector would be undoubtedly high, the scenario theorised could promote competition and at the same time act as deterrent for collusive behaviors.

Further, it is submitted that information exchange agreements should be allowed only if and to the extent to which they are strictly necessary for the correct functioning of the network system.

Taking into account the considerations arising from the “outward looking perspective” of this Chapter, the time has now come to close the circle and unravel some conclusive remarks in relation to the Application of Art. 101 to the financial services sector. This shall be done in the following.

⁶⁹⁶ See the Commission’s Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, above, at paragraph 99.

⁶⁹⁷ See Commission Regulation (EU) No 267/2010 of 24 March 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of agreements, decisions and concerted practices in the insurance sector, above, Art. 3(2) e. Under the current regime, single individuals are not in the position to have access to these data. Further, the requirement enshrined in Art. 3(2) e is subject to an exemption non the basis of public security issues.

PART V: THE WAY FORWARD

10 Art. 101 and the Financial Services Sector: The Way Forward

10.1 Introduction

This thesis embarked on an arduous journey in search for answers related to the application of Art. 101 of the Treaty of Lisbon to the financial services sector. This journey has been long and unperturbed and led to the exploration of the internal market as well as the US scenario.

In the meantime, in order to answer the same questions, the Commission started and concluded official investigations, a new Treaty (the Treaty of Lisbon) entered into force, and a new Block Exemption Regulation for the insurance industry was enacted.

The Commission findings during the last few years and the new Insurance Block Exemption regulatory framework have proven to be, at least partially, in line with the ideas of the author of this thesis.

The time seems now ripe to endeavour to provide some final answers and to clarify the teleological stance of this thesis.

This Chapter shall in the first place address and attempt to rebut possible criticisms of the structural apparatus of this research; the first, and, arguably to some, de-synchronised issue lies with the original idea of taking into consideration the financial services sector intended as the insurance and banking sectors.

Secondly, we shall endeavour to defend the claim for open competition in the financial services sector in light of the arguments elaborated in the previous chapters of this thesis.

10.2 In defence of the conceptual *status quo* of this thesis: Insurance and Banking sectors as two faces of the same coin

As established at the beginning of this thesis, a very strong bond appears to link together the banking and insurance industries.

Banking and insurance undertakings are both financial intermediaries who perform very similar functions.

Apart from similarities related to the nature and the function of the services provided, we have established that a closer linkage between insurance and banking industries emerged in the last few years, due to a wave of innovation triggered by a process of liberalisation and innovation which characterised the financial services sector across Europe⁶⁹⁸.

As a result of these phenomena, the “financial” element of insurance products has increased considerably during the last few years especially through the establishment of banking-insurance conglomerates, closing even further the already existent areas of overlaps between the insurance and banking sectors.⁶⁹⁹

10.3 Competition law and the Financial Services Sector

In conjunction with the establishment of deep synergic connections between insurance and banking undertakings, competition between the banking and insurance

⁶⁹⁸ See Chapter 1 above.

⁶⁹⁹ *Ibid.* M. D. Knight provides the example of single premium unit-linked insurance policies, which, according to the author, “compete directly with other financial products as resting places for household assets”. As investors in and suppliers of guarantees, insurers have also become increasingly active in credit derivatives and structured finance products.

industries has been intensified dramatically in the course of the last few years.⁷⁰⁰ This turned out to be severely at odds with the old anti-trust *status quo*. Traditionally, the financial services sector used to be a state prerogative due to the *quasi*-social nature of the services provided by undertakings operating within this industry. Not so long ago, in many Member States insurance services used to be indeed solely provided by the state, and the banking system was heavily controlled by governments.⁷⁰¹

With the advent of the European Community (nowadays European Union) the situation changed drastically, leading to the introduction of radical reforms of the financial services industry in several Member States. As a result, the previous government monopolistic approach was left behind in favour of heavy private sector involvement, which increased competition inevitably igniting, at the same time, anti-trust concerns.

The complexities arising from the application of the EU anti-trust rules to the financial services industry are, as it has been established in the course of this thesis, many.

In the first place, one of the main features of this industry is denoted by the fact that market members can seamlessly assume the form of retailers, wholesalers, customers and suppliers, with the wholesale market capable of affecting retail customers indirectly.⁷⁰²

Secondly, the entire financial services industry appears to be characterised by atavistic features *prima facie* incompatible with anti-trust regulatory frameworks.

⁷⁰⁰ For instance, as far as the management and life insurance segments are concerned, the two industries have strived to gain the allegiance of a richer, ageing retail customers in conjunction with the lack of guarantees offered by national pension systems.

⁷⁰¹ *Inter alia*, Italy and France.

⁷⁰² See Faull and Nickpay, “*The EC Law of Competition*” OUP 2007, p. 636.

A further point of general relevance for the application of the EU competition rules to the financial services sector is represented by the process of financial integration still on-going at European level. Various banking, insurance and investment services Directives have been implemented in the course of the last years with the aim of creating a ‘single passport’ system aiming at facilitating the integration process of the community financial markets through the promotion of cross-border activities and the increment of competition. Despite the Community efforts to establish a single market for all financial services, both banking and insurance services are still mainly provided within the domestic sphere of individual Member States and cross-border competition is still very limited.⁷⁰³

In such an intricate scenario, anti-trust issues may indeed arise in relation to mergers and acquisitions, possible abuses of dominant positions and state aid. Nevertheless, we have seen that Art. 101 and the discipline of forms of co-operation represent the paramount and most intricate aspect of the application of the EU competition rules to the financial services sector. Whilst it is allegedly essential for banks to co-operate in order to provide payment systems, for insurance firms both horizontal agreements (i.e. information sharing and pooling agreements) are deemed to be necessary in order to spread risks and face insolvency risks. Art. 101 seems therefore to represent a common thread between these two industries, posing at the same time interesting teleological dilemmas, which this thesis has endeavoured to answer.

The main dilemma is represented by the fact that the Commission has allowed forms of “horizontal agreements concerning a relevant cost element making up the

⁷⁰³ See the Commission report on Insurance and the commission Report on Banking, above.

final price *vis-a-vis* customers”⁷⁰⁴ through its decisions relating to interbank fees in payment systems and through its insurance block exemption.

Having arguably established in the course of this thesis the existence of a teleological link between the insurance and banking sectors, it is now time to draw some conclusive lines in relation to a series of rather intricate questions which this thesis has endeavoured to answer: ought Art. 101 to apply to the financial services sector at all? If so, to what extent? Is there any justification for a block exemption in the insurance sector? Should the banking sector benefit from a block exemption as well?

10.4 Ought Art. 101 to apply to the financial services sector at all?

Still now much debate surrounds the issue of the application of Art. 101 to the financial services industry. We have seen that traditionally both banking and insurance undertakings vehemently rebutted the idea of being fully exposed to the EU Competition rules⁷⁰⁵. Apart from peculiarities which characterise the insurance and banking sector individually, the *quasi* social nature of financial services represents the first and foremost argument against the application of Art.101.

The eradication of public ownership in conjunction with the gradual establishment and enactment of the internal market has lead in the course of the years to a complete different scenario, whereby insurance and banking undertakings nowadays assume the form of private entities very much orchestrated and moved by entrepreneurial and corporate interests.

The application of EU competition law to the financial services sector is therefore now more than ever of the utmost importance, and, as established above,

⁷⁰⁴ See Faull & Nikpay, “*The EC Law of Competition*” OUP 2007, p. 636.

⁷⁰⁵ See Chapters 2 and 5 above.

among the EU competition rules it is opinion of the author that Art.101 gives rise to the most sensitive issues due to the allegedly naturally atavistic need for horizontal co-operation claimed by both insurers and banks.

On the one hand, it is undeniable that both insurance and banking undertakings provide services of a ‘different nature’ compared to other sectors of the economy. In this regard, the ‘public sector imprinting’ characterising insurance and banking activities appears to represent significant proof of the quasi social nature of financial services activities. On the other hand, one needs first to consider that other sectors of the economy also providing essential services such as energy and telecommunication have never disputed the application of antitrust rules, nor were they subject to special consideration beyond the process of integration at European level.

The rapid growth of the financial services sector in the last three decades, in conjunction with the privatisation process and the enactment of the internal market, render the possibility of advocating for a complete and indiscriminate exemption of this sector of the economy from the application of Art 101 an arduous task. The need for a full application of Art. 101 to both insurance and banking sector represents therefore unsurprisingly the first conclusive yardstick of this thesis. The precise extent of the application of Art. 101 to the insurance and banking sector shall be considered in the following in light of the conclusions so far reached.

10.5 The extent of the application of Art 101 to the insurance industry

In the course of this thesis, it has been argued that the impact of the insurance block exemption on the internal market represents one of the igniting causes for a high degree of consolidation at cross-border level not accompanied by an enhancement of

cross-border provision of insurance services. The outcome of this state of affairs is that competition among insurance undertakings appears to be restrained and insurance policies prices not well diversified.

This stagnating scenario has recently led the Commission to drastically reduce the scope of application of the new Insurance Block Exemption Regulation. As from March 2010, the drawing up of standard policy conditions for direct insurance and common rules for approving security devices will no longer be part of EU block exemption regulatory framework. In line with the recent EU developments, in the US much debate surrounds the idea for a complete repeal of the Insurance block exemption; and this appears to be a concrete development on the verge to happen.

It is the opinion of this author that repealing the block exemption could arguably have beneficial effects. Nevertheless, a complete repeal not accompanied by ancillary measures may not be an optimal solution and create uncertainty and idiosyncrasies within the internal market.

It is, thus, suggested that a repeal of the block exemption should go *pari passu* with the simultaneous enactment of possible alternative regulatory frameworks. In particular, the introduction of a system of ‘tailor made’ or ‘individualised’ insurance policies illustrated by this thesis might represent a valid solution for some forms of insurance (e.g. especially liability or fault based insurance) in terms of consumer welfare, competition, and the economics of moral hazard.

As previously established, the introduction of ‘tailor made’ insurance policies in conjunction with the enactment of effective competition in the insurance industry could indeed arguably act as a deterrent also capable of facing the so called ‘moral

hazard' problem efficiently. The creation of an effective linkage between the behaviour of the insured and the insurance policies would entail the possibility to use competition law as an implementing tool for reconciling liability rules with deterrent functions in order to face moral hazard issues in an optimal way⁷⁰⁶.

Another valid suggestion which stems out the US debate might be to accompany the repeal of the insurance block exemption with the enactment of safe harbours protecting possible pro-competitive behaviours, such as the common coverage of certain types of risks (e.g. nuclear, environmental, aviation and terrorism). This would enable the industry to adjust to the new *status quo*, and to face the inevitable degree of uncertainty arising from the complete exposure of the insurance industry to the application of Art. 101 TFEU.

Such ancillary measures would be of the foremost importance, especially considering the difficulties that would arise should the application of the EU current block exemption regulatory framework for forms of horizontal co-operation be envisaged (Regulations 1217/2010⁷⁰⁷ and 1218/2010⁷⁰⁸).

Regulation 1217/2010 will be difficult to apply due to the nature of the agreements that it covers, i.e. research agreements for the technological developments of industrial products. If the current insurance block exemption was to be repealed, co-operation agreements between insurers on joint compilations, tables and studies, or joint coverage of risks would fall short of the scope of application of Regulation 1217/2010. This is due to the fact that the regulation *per se* was designed

⁷⁰⁶ See Chapter 3 above.

⁷⁰⁷ Commission Regulation (EU) No 1217/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty on the functioning of the European Union to categories of research and development agreements, OJ L 335/36.

⁷⁰⁸ Commission Regulation (EU) No 1218/2010 of 14 December 2010 on the application of Article 101(3) of the Treaty to categories of specialisation agreements, OJ L 335/43.

to cover technological industrial research or intellectual property rights leading to the elaboration of new products⁷⁰⁹.

It would be arguably very difficult to conceptually construe the nature of the aforementioned insurance agreements as technological industrial research, and to consequently force their nature into the scope of application of the Regulation.

By the same token, serious difficulties would also emerge in the application of Regulation 1218/2010. This Regulation was designed in order to cover specialisation agreements, i.e. “unilateral specialisation agreement, a reciprocal specialisation agreement or a joint production agreement”⁷¹⁰. If on the one hand one may categorise information exchange agreements, or insurance pools between insurers as specialised agreements, insurmountable obstacles would arise from the Regulation itself which was designed to cover situations where undertakings agree to “partly cease production of certain products or to refrain from producing those products and to purchase them from the other party, who agrees to produce and supply those products”⁷¹¹.

If Regulations 1017/2010 and 1018/2010 would not be of great help in case of repeal of the current insurance block exemption regulatory framework, nor can relief be found in the *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements*⁷¹². Under the Guidelines, horizontal forms of co-operation between insurers would fall, indeed, under the category of situations to be assessed on a case-by-case basis⁷¹³.

⁷⁰⁹ See Regulation 1217/2010, above, Recitals 1 and 9 and Article 1.

⁷¹⁰ See Regulation 1218/2010, above, Article 1.

⁷¹¹ *Ibid.*

⁷¹² Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements, 14.1.2011, OJ C 11/1.

⁷¹³ *Ibid.*, at Paragraph 75. Under the Guidelines, information exchange agreements must assess on an individual basis, taken into account the peculiarities of the situation considered.

Turning to the consequences of a complete repeal of the block exemption, it is opinion of the author that the achievement of a fully competitive insurance market accompanied by the introduction of a system of individualised insurance policies might also arguably ignite the release of a greater variety of policies. A greater variety of insurance policies may lead to a higher degree of guarantee for the insurability of risks, and could ultimately limit risk pools otherwise deemed to be necessary in order to avoid the risks of moral hazard and adverse selection.⁷¹⁴

Further, repealing the current block exemption and introducing a system of effective competition among insurers may also result in remarkable improvements in terms of efficiency and correct functioning of the entire insurance industry.⁷¹⁵

The current scenario is, indeed, characterised by the possibility of insurers to indulge in anticompetitive behaviours relying upon the shield offered by the block exemption. It is not a secret that rate service organisations and information sharing allow insurers to engage in price fixing practices, and consequently to limit the number of competitors within the market. Furthermore, in the course of this thesis it has been argued that the possibility to utilise a pool of shared data renders it superfluous for insurance companies to monitor their own costs, ultimately leading to “inefficiencies that would not otherwise exist.”⁷¹⁶

⁷¹⁴ We have seen that in absence of a block exemption for the joint calculation and studies of risks, the enforcement of an ‘insurance tailor made system’ might arguably lead to a diversification of prices and of an enhancement of competition beneficial for both insurers and insured. Furthermore, the diversification of policies would reflect the behaviour of the insured, helping to reach an optimal control of moral hazard risks narrowing the need for risk pools.

See M. Faure, *“Insurance and competition law: balancing the conflicts”*, above, p. 23. on this point see also G. Priest, *“The current insurance crisis and modern tort law”*, Yale Law Journal, 1987, pp. 1521-1590.

⁷¹⁵ See *“The testimony of the Director of Insurance Consumer Federation of America before the Committee on the Judiciary of the U.S. Senate, regarding the implications of repealing the insurer’s antitrust exemption”*, above, p. 16.

⁷¹⁶ See *“Comments to the Antitrust Modernization Commission regarding the McCarran-Ferguson Act”*, available at: http://govinfo.library.unt.edu/amc/commission_hearings/pdf/060410-ABA_re_McCarran_Ferguson.pdf.

If we consider comparative elements stemming out of other sectors of the economy, we have established that the most important element of differentiation between the financial services sector and other structurally comparable industries such as the telecommunications and energy industries, is the presence of a block exemption for the insurance sector.

Going above and beyond these considerations, the case law further shows that forms of cooperation capable of impairing competition were allowed by the Commission in the energy sector by reasons of absolute necessity⁷¹⁷, and that the same rationale was applied in the telecommunication sector.⁷¹⁸

Nevertheless, we have also seen that both in the energy and telecommunications industries the antitrust assessment of a network went beyond the functionality for the provision of services, considering also anticompetitive spill over effects vis-à-vis new market entrants.

As previously established, if we were to apply the same line of reasoning to the insurance industry transcending the substantive differences between these two sectors, the questions to be answered appear to be essentially two: are forms of co-operation between insurance undertaking necessary in order to provide insurance services? If so, are network elements capable of having a positive impact on new market entrants?

We have just re-emphasised that specific types of risk (e.g. nuclear, terrorism etc.) and specific line of insurance (i.e. re-insurance) apart, the entire conceptual castle built around the necessity for co-operation between insurers could arguably be

⁷¹⁷ Commission Decision *International Energy Agency* of 21 February 1994 relating to a proceeding under Article 85 of the EC Treaty, [1994] OJ L68/35.

⁷¹⁸ Commission Decision *T-Mobile Deutschland/O2 Germany*, Case COMP/38.369, 16.06.2003. OJ L 75/32.

dismantled by way of alternative regulatory solutions (i.e. insurance transcripts and tailor-made insurance policies).

Furthermore, we have established that in the telecommunications sector cooperation between undertakings is tolerated in view of the possibility for Member States to impose network sharing obligations vis-à-vis existing undertakings part of an infrastructural network. Here a regulatory framework introduced by way of legislation⁷¹⁹ was seen as a mitigating factor for possible anticompetitive effects of network sharing agreements. In absence of a similar regulatory solution in the insurance sector, the justification and relative exemption of horizontal agreements arguably becomes more difficult.

In addition to the aforementioned suggestions, further alternative regulatory frameworks can revolve around command and control regulation, incentive regulation, self-regulation, voluntary agreements.

Command and control regulation would be based on the enactment of specific governmental guidelines on how to comply with mandatory requirements in the insurance sector. This kind of approach would need to be implemented at European level, as it needs to be based on a harmonised and consistent regulatory framework in order to be truly effective (discrepancies in the approach by different Member States would undermine the system). Even so, discrepancies could still arise due to the differences in the insurance markets across the internal market despite the attempts of harmonisation of the European Union. A ‘light’ command and control approach could be still devised and be confined to specific aspects, e.g. the obligation of disclosure and transparency on insurers in relation to rates making procedures; this could assist consumers in making informed choices and foster competition in the

⁷¹⁹ Directive 2002/21/EC, above.

sector⁷²⁰. When it comes to the insurance industry, transparency is indeed an issue, and the identification of the appropriate form of regulation (or sometimes of de-regulation) often starts with the notion of market failure.

The telecommunication sector considered in the above paragraphs provides for an emblematic example of this paradigm. The market failure of this industry has been at the outset identified in its naturally monopolistic nature, and was faced through a gradual process of liberalisation and privatisation of the sector which, as we have seen in the above, nevertheless left open competition issues of access to the market and access to essential facilities by new entrants into the market. Similarly, the insurance sector - as well as the banking sector - started out (at least in continental Europe), as sectors dominated and monopolised by the *'longa manus'* of governments of individual Member States. Forms of horizontal co-operation in this industry can arguably be seen as a market failure, the answer to which has thus far been a block exemption.

In addition to specific alternatives which have been already identified, a further option would be incentive regulation, a solution adopted in the energy sector which has been the object of analysis in the previous Chapter. The liberalisation process of this sector which also used to be characterised by a monopolistic dimension has been accompanied by forms of incentive regulation in the form of price cap mechanisms, the most common form of incentive regulation. The introduction of price cap mechanisms in the insurance industry would be of difficult execution. According to economic doctrine, in order to be truly effective, forms of incentive regulation based on price cap mechanisms should be accompanied by other

⁷²⁰ See E.N.Csaszar, "*Competitive Markets and Regulatory Reform in the US*", available at: <http://www.nottingham.ac.uk/>

incentive mechanisms in order to address issues of service quality⁷²¹. This would require the implementation of “periodic accounting, auditing, capital service, and cost of capital measurement protocols.”⁷²²

A system of this kind would be of difficult application when it comes to the insurance sector. The reason for this lies with the high degree of uncertainty surrounding the nature of this business insurance; whilst in the energy sector it is possible to estimate provision costs with a degree of certainty, the opposite can be said for insurers whose costs are ultimately linked to the realisation of the risks insured.

Another possible alternative is represented by self regulation and voluntary arrangements. This approach is based on voluntary agreements/codes to be enacted by the insurance industry itself, although they could also be superimposed via legislative requirements (this is what happened in the Australian telecommunication industry where a scheme of industry codes and standards was established by the legislator)⁷²³.

The introduction of standards and codes by the insurance industry could indeed be an interesting alternative, insofar as transparency is ensured and consequences in case of non compliance are pre-determined and enforced. This scenario could even be considered for the introduction of tailor-made insurance policies theorised in this thesis as the most significant alternative to a block exemption in the form of joint statistics and studies of risks.

⁷²¹ See P.L. Joskow, “*Incentive Regulation in theory and practice*”, the MIT Centre for Energy and Environmental Policy Research, 2006, available at: <http://www.hks.harvard.edu/>

⁷²² *Ibid.*, p. 82.

⁷²³ See the Australian Treasury, “*Industry self regulation in consumer markets*”, available at: <http://www.treasury.gov.au/>

In light of these considerations and the imminent changes that the insurance industry is on the verge of facing due to the reduction of scope of the new block exemption regime, a complete repeal of the block exemption system does not seem to be too remote and might represent the natural way forward.

10.6 The extent of the application of Art. 101 to the Banking industry

The antitrust issues arising from the application of Art. 101 to the banking sector have been addressed in relation to price competition and non-price competition issues: two separate, nevertheless at the same time strictly connected areas.

When it comes to price competition, MIFs and no-discrimination rules have been analysed within the context of card payments systems which represent the foremost means of payment used by consumers, giving rise to serious competition concerns⁷²⁴.

In the course of this thesis, it has been established that MIFs and no-discrimination rules have been an integral part of any card payment network since the dawn of the creation of credit/debit card payments systems, and that the analysis of their effective impact on competition has led to more than ‘three decades of antitrust uncertainty’⁷²⁵.

On the one hand it is undeniable that both MIFs and no-discrimination rules represent blatant restrictions on competition; on the other hand attempts have been made to justify their use especially in consideration of the peculiar aspects of four party payment networks intended as two-sided markets. Economic theories maintain

⁷²⁴ In Europe, card transactions cover approximately 70 per cent of the payment transactions (see the “*Commission’s Interim Report on Payment Cards*”, above, at p. 12).

⁷²⁵ See S. Semeraro, “*Credit Cards Interchange Fees: Three Decades of Antitrust Uncertainty*”, above.

that within such markets, competitive forces operate in a *sui generis* way so as to render MIFs and no-discrimination rules allegedly essential for the correct functioning of card payment networks.

These arguments have certainly been embraced by the US courts, the European Courts, and the European Commission which tolerated (although with the imposition of certain requirements) MIFs and no-discrimination rules.

Such an approach was in part justified by the novelty and the progressive success of card payment networks. This led to a cautiously ‘hands off’ regulatory approach within which any idea of regulatory intervention was curtailed by the risk of compromising the development of new and very efficient payment systems.

Time is arguably now ripe enough for a re-assessment of the antitrust implications of MIFs and no-discrimination rules. Empirical evidence appears to demonstrate their anti-competitiveness⁷²⁶ and, most of all, their non-essentiality for the correct functioning of card payment networks⁷²⁷. Alternatives such as bilateral negotiations between the members of card payment systems could arguably represent a feasible and more ‘competition friendly’ way to recover transactions costs for the banks members of a four party card payment scheme.

In years to come, competition authorities and regulatory bodies will be asked to re-evaluate MIFs and no-discrimination rules. It is submitted by the author of this thesis that the possible regulatory approaches are substantially two: keep acknowledging the necessity of such agreements, or declare them unlawful.

The former approach (currently adopted by the EU Commission and by the US courts), if confirmed, should aim to mitigate possible anticompetitive side effects through the imposition of disclosure requirements and strict control

⁷²⁶ See the Commission Report on Retail Banking, above.

⁷²⁷ *Ibid.*

mechanisms on their effective correspondence to transactions costs. In addition, devices designed to bypass MIFs (e.g. bilateral forms of negotiations) should always be allowed.

The latter solution would remove the possibility to use MIFs within card payment systems allowing bilateral negotiations instead. This approach should put particular emphasis on consumer protection, as consumers might suffer from the consequent possibility for merchants to surcharge clients in order to recover transaction costs. The imposition of disclosure requirements on merchants in relation to fees, in conjunction with a general prohibition to surcharge consumers more than required by the need to compensate effective costs, should ensure consumer protection granting at the same time intra-system competition.

Overall, it is suggested that both the above approaches should be based on the illegality of no-discrimination rules as non-necessary for the functioning of card-payment networks. This research has emphasised the extremely negative consequences on competition of no-discrimination rules which only with extreme difficulty can be balanced against their alleged positive effects and qualify for an exemption under Art. 101 (3).

This thesis has also considered non-price competition issues under Art. 101. Although not directly related to price matters, non-price competition issues are indeed capable of having a negative impact on competition, and have been the object of scrutiny by antitrust authorities both in the EU and USA.

Exclusion rules (which prevent competitive financial institutions from having access to the system), and exclusivity rules (which disallow the possibility for members of card payment systems to issue competitive cards) are the most controversial non-price competition issues from an antitrust perspective. It is

generally maintained that the rules in question represent a necessary form of protection for payment systems, as the establishment of such networks is the result of considerable investments by their founders, who consequently are not inclined to allow external players to have a free ride.

Nevertheless, important competition concerns arise around exclusion rules and exclusivity rules especially if these systems can be theorised as essential facilities according to the essential facility doctrine.

The need for protection of the system must be counter-balanced against the necessity for competition, both at an intra-system and inter-system level. It has been emphasised that, in practice, although exclusion rules give rise to intra-system competition concerns, whereas exclusivity rules are more related to inter-system competition, indeed these two different sets of rules represent two sides of the same coin. Similarly intra-system and inter-system competition are strictly inter-related.

Consequently, the regulation of these two issues should consider a *pari-passu* approach. The US approach aiming at ensuring an adequate level of competition at inter-system level alone, might in practice result in intra-system competition being undermined in the long run. By way of comparison, the approach of the Commission which considers both exclusion and exclusivity rules to be at odds with EU competition law has the added benefit of coherency, especially if the linkage between price and non-price competition issues is considered.

It is indeed submitted that price and non-price competition issues are strictly related to one another. If MIFs and non-discrimination rules used by card payment systems raise issues related to intra-system competition, non-price competition agreements such as exclusion or exclusivity rules revert both to intra and inter system competition. We are basically dealing with two sides of the same coin; this is the

reason why it is suggested that both non-price and price competition agreements should be subject to a similar regulatory framework.

As with the insurance sector, yet again a comparison with other segments of the market arguably corroborates the above conclusions. Here an interesting parallel could be made with the situation arising from the creation of the “*Verbandevereinbarungen*” agreements in the energy sector, where association agreements between network operators were permitted due to the technical difficulties incurred by individual undertakings in creating their own networking system. Similarly to multilateral interchange fees agreements, the *Verbandevereinbarungen* agreements provide for common criteria for the calculation of fees and common access rules.

More interestingly, the rationale for the compatibility of the *Verbandevereinbarungen* agreements with Art. 101 was that such agreements were deemed capable of reducing transaction costs for third parties seeking access to the system, and of being ultimately beneficial for consumers. This seems arguably to reinforce the conclusions reached in relation to the regulation of multilateral interchange fees, where the need for mechanisms of control of cost efficiency of the fees was advocated in order to avoid possible negative spillover effects *vis-à-vis* consumers. If the line of reasoning for the assessment of the *Verbandevereinbarungen* agreements was to be applied to multilateral interchange fees and no-discrimination rules, the key criterion for their antitrust evaluation would, indeed, revolve around the capability of these agreements to curb transaction costs and not to reverberate against third parties seeking access to the network or consumers.

The outcome of such assessment would arguably lead to emphasis on the need for strict forms of control on the effective correspondence of multilateral interchange fees to transactions costs, and the abolishment or strict scrutiny of any type of exclusivity rules or exclusion rules capable of hindering access by third parties.

The same considerations are arguably valid if applied to networking agreements in the banking sector such as the SWIFT or the *Dresdner Bank* circuits analysed above⁷²⁸. In both cases, the possibility to reduce transaction costs and improve services for consumers would lead to the judicial admissibility of co-operation agreements with a caveat advocating for strict mechanisms of cost-efficiency control, which do not seem to be currently enacted.

⁷²⁸ See Chapter 6 above.

PART VI - CONCLUSIONS

11 Art.101 and the Financial Services Sector: Concluding remarks

11.1 Conclusions

This thesis has now reached its final port of destination. The long and impervious road it has embarked upon a few years ago has led to a complete re-assessment of the application of Art. 101 TFEU to the financial services sector.

Since the journey started, much debate has arisen around the issues addressed by this thesis proving that the choice of topic has indeed been worthwhile. In addition, developments such as the introduction of a new and far narrower block exemption regulatory framework for the insurance industry, and the advent of seminal Commission decisions in Visa and MasterCard need to be taken as indications of the dawn of a new area.

Far from being close to the ultimate stage, the controversial issues relating to the application of Art. 101 to the financial services sector are yet to be resolved and will continue to evolve in the future.

This thesis claims that the time has now come for a re-consideration of the competition regulatory framework for the banking and insurance sector, both industries to be intended as two faces of the same coin.

Despite the undeniable *quasi* social nature of banking and insurance services, the long process of privatisation which characterised this area of the market in conjunction with the efforts made by the Community to create an internal market for the provision of banking and insurance services, introduced radical changes to the *status quo*. Both the insurance and banking sectors are driven by interests of a corporate and entrepreneurial nature, and many insurance and banking undertakings are operating on a market which is becoming more and more competitive. Competition seems therefore to play more than ever a role of the utmost importance, and the time seems ripe for the eradication of old time idiosyncrasies.

The first seminal conclusion of this thesis is that both the insurance and banking sectors should be fully exposed to the application of Art. 101. In light of the above considerations, it is indeed submitted that there is arguably no justification for block exemptions or extended forms of tolerance of collaborative and collusive

practices in the financial services sector. It is the opinion of the author that a complete repeal of the insurance block exemption could arguably have beneficial effects.

Nevertheless, a complete repeal not accompanied by ancillary measures may not be an optimal solution and create uncertainty and idiosyncrasies within the internal market. It is therefore suggested that a repeal of the block exemption should go *pari passu* with the simultaneous enactment of possible alternative regulatory frameworks such as the enactment of a system of ‘tailor made’ or ‘individualised’ insurance policies. This could lead to the diversification of insurance policies, and might result in beneficial effects in terms of consumer welfare, competition, and the economics of moral hazard.

A similar treatment is hereby advocated for the banking industry. MIFs and non-discrimination rules used by card payment systems raise serious competition concerns in relation to intra-system competition, and non-price competition agreements such as exclusion or exclusivity rules, on their part revert both to intra and inter system competition. This thesis arguably proved the existence of clear linkage between MIFs and no-discrimination rules in the first place, and secondarily between price and non-price competition agreements such as exclusion or exclusivity rules. As established in the course of this thesis, when it comes to the banking sector a teleological link appears to interconnect intra-system and inter system competition, giving rise to a domino effect which reverts against the entire competitive *acquis* of the banking sector.

Past experience suggests that a regulatory framework which tolerates MIFs without eradicating no-discrimination rules is likely to produce inefficient results.⁷²⁹

⁷²⁹ See Chapter n 6 above and the Swedish and Australian past approach to Mifs.

The starting point would therefore be not to tolerate the use of MIFs and no-discrimination rules within card payment systems allowing bilateral negotiations instead. Exactly as it has been suggested for the removal of the insurance block exemption, the enactment of ancillary measures should accompany the eradication of MIFs and no discrimination rules.

In this regard, it is submitted that the imposition of disclosure requirements on merchants in relation to fees, in conjunction with a general prohibition to surcharge consumers more than required by the need to compensate effective costs, should ensure consumer protection granting at the same time intra-system competition.

Since intra-system and inter-system competition appear to go *pari-passu* when it comes to the banking industry, it is opinion of the author that non-price competition agreements such as exclusion or exclusivity rules should also be intended as forms of co-operation contrary to art. 101 and therefore declared void. This would arguably ensure an adequate level of competition among banking undertakings, whose positive effects might reverberate as far as ultimately reaching customers.

These conclusions appears to be corroborated by a comparative analysis with other sectors of the economy (telecommunication and energy sectors) conducted at the end of this thesis. Overall, the main lesson to be learnt by the application of Art. 101 to the telecommunication and energy sectors appears to be that, in absence of any block exemption, a careful assessment of forms of co-operation between undertakings in the financial services sector would be of the utmost importance. It is opinion of this author, that only through a careful and meticulous scrutiny of the nature of proposed agreements between insurance or banking undertakings stability

in the market and enhancement of competition in the financial services sector may be attained.

In line with the considerations expressed in the course of this thesis in relation to forms of horizontal co-operation in the insurance and banking sector, particular emphasis should be put on the indispensability of the agreements and efficiency claims and cost efficiencies should be carefully counter-balanced vis-à-vis restrictions and impact on consumers.

In case of network agreements, the assessment of entry barriers and the real possibility for new entry on a significant scale, should devote particular attention to the necessity of internal rules or bylaws and their potential impact on possible new market entrants. Further, information exchange agreements should be allowed only and to the extent that they are strictly necessary for the correct functioning of the network system.

These are the conclusive remarks of this thesis which has finally reached its final port of destination. As for the issues surrounding the application of Art 101 TFEU to the financial services sector, the journey seems to be still a long time coming. Or possibly not?

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